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BEFORE THE ARIZONA CORPORATION

IN THE MATTER OF THE APPLICATION OF)
LITCHFIELD PARK SERVICE COMPANY, AN) DOCKET NOS.
ARIZONA CORPORATION, FOR A) SW-01428A-09-0103
DETERMINATION OF THE FAIR VALUE OF) W-01427A-09-0104
ITS UTILITY PLANTS AND PROPERTY AND) W-01427A-09-0116
FOR INCREASES IN ITS WASTEWATER RATES) W-01427A-09-0120
AND CHARGES FOR UTILITY SERVICE BASED)
THEREON.)
AND ALL RELATED MATTERS.)

At: Phoenix, Arizona

Date: January 14, 2010

Filed: JAN 20 2010

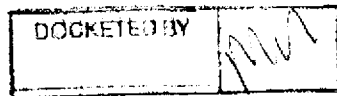
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Arizona Corporation Commission

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NO. DESCRIPTION

IDENTIFIED

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1 BE IT REMEMBERED that the above-entitled and
2 numbered matter came on regularly to be heard before the
3 Arizona Corporation Commission, in Hearing Room 1 of
4 said Commission, 1200 West Washington Street, Phoenix,
5 Arizona, reconvening at 9:34 a.m. on the 14th of
6 January, 2010.

7
8 BEFORE: DWIGHT D. NODES, Assistant Chief
9 Administrative Law Judge

10 APPEARANCES:

11 For the Applicant:

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13 By Messrs. Jay L. Shapiro and Todd C. Wiley
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15 For the Residential Utility Consumer Office:

16 Ms. Michelle L. Wood, Staff Attorney
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18 For the City of Litchfield Park:

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8 Certified Reporter
9 Certificate No. 50658

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1 ACALJ NODES: Any preliminary matters?

2 MR. SHAPIRO: I just want to let you know, we
3 have let the parties know, but that LPSCO does intend to
4 call two rebuttal witnesses. One is Mr. Sorensen, who
5 will return to the stand and address retirements and
6 rate case expense. The other is Mr. Ray Jones. We
7 filed his summary yesterday. He will address
8 Mr. Rowell's testimony, which essentially is a change of
9 position that the disallowance should now be made
10 because it is simply unreasonable, unfair, excessive by
11 virtue of the fact it was done so soon.

12 ACALJ NODES: Okay. What about the item that
13 Chairman Mayes had asked about, the phase-in? Is
14 Mr. Sorensen going to be addressing that issue?

15 MR. SHAPIRO: The company intends to propose a
16 phase -- to address a phase-in in its final brief, its
17 final schedules. It does intend to propose that rates
18 be phased in, and we intended to do that in our final
19 schedule. I don't know if -- we can certainly ask
20 Mr. Sorensen about it if there are specific questions.

21 ACALJ NODES: Okay. Well, I think that was kind
22 of -- if you wait until your brief, and I understand
23 this was raised at the start of the hearing, but there
24 is no opportunity to ask questions about what the
25 company is going to be proposing if you wait until your

1 brief.

2 MR. SHAPIRO: Well, I guess the company of
3 course, as Mr. Sorensen testified, is in a bit of an
4 awkward position. We also haven't heard from any other
5 party regarding their proposed phase-in, and RUCO rested
6 its case. So to some extent the company has not
7 finalized 100 percent its proposed phase-in numbers. I
8 think Mr. Sorensen can certainly present what the
9 company believes a phase-in should entail and the way it
10 should work. We are happy to do that.

11 ACALJ NODES: Okay. All right. Just,
12 Mr. Sorensen, be prepared, there may be some questions
13 about what a phase-in might look like and what the
14 company is looking at in that regard.

15 MR. SORENSEN: Yes, sir.

16 ACALJ NODES: That's fair enough.

17 Okay. Any other matters?

18 MS. WOOD: Yes, Your Honor. If RUCO could be
19 heard on the issue of a witness that has not filed
20 prefiled testimony be included in the rebuttal case.

21 ACALJ NODES: Go ahead.

22 MS. WOOD: Essentially in this case the Town of
23 Goodyear was precluded from participation because they
24 hadn't filed prefiled testimony. So they were only
25 going to be submitting public comment, as directed by

1 Staff, according to Mr. Iwanski's opening statement.

2 In the last case we had with the company
3 Mr. Schirtzinger wanted to submit evidence, but he was
4 told that because he had not submitted prefiled
5 testimony, he would not be allowed to submit evidence in
6 the case because it was a due process issue and a
7 fairness issue.

8 We agree that it is a due process issue.
9 Mr. Jones, who I have not read any testimony from
10 because he has not submitted any, nobody in the room has
11 had an opportunity to review his testimony, and I don't
12 think it is, from RUCO's perspective, a proper notice
13 for us to be able to effectively cross-examine the
14 witness when we have never heard his testimony or had it
15 in prefiled testimony, as everybody in the room has
16 participated in prefiled testimony.

17 ACALJ NODES: Okay. Well, let's just break down
18 your comment. First of all, the City of Goodyear never
19 filed a motion to intervene, I don't -- to my
20 understanding, they did not.

21 MS. WOOD: I am only taking the words that I
22 hear Mr. Iwanski say, that he had intervened but he had
23 neglected to file prefiled testimony. Now, maybe I am
24 incorrect in that. That is what I heard him say in
25 public comment.

1 ACALJ NODES: I don't believe I ever saw a
2 motion to intervene from the City of Goodyear. And so I
3 don't believe they did file anything. I think they made
4 a decision for whatever reason as to their level of
5 participation.

6 If you are going to refer back to the,
7 Mr. Schirtzinger, whatever the gentleman from Black
8 Mountain, the Black Mountain case, he was offered an
9 opportunity to participate. He opted to give public
10 comment.

11 But really, at its core, you are talking about
12 rebuttal testimony it seems to me, which is the company
13 is always offered an opportunity to rebut as a final
14 matter what is raised during the course of the hearing.
15 And it is typical when that's presented that even if it
16 is the same witness who previously testified in prefiled
17 testimony, what that witness is going to offer in
18 rebuttal is not prefiled, that we take oral testimony
19 from such a witness.

20 And so I don't know that it matters if it is the
21 person who previously testified as far as rebuttal goes.
22 But, you know, I mean I always try to err on the side of
23 giving people plenty of opportunity to prepare. And
24 maybe that's the remedy, but -- well, let me hear from
25 Mr. Shapiro about his thoughts on it.

1 MR. SHAPIRO: Well, I agree with everything you
2 said, Judge Nodes. I would simply add that had we had
3 notice that Mr. Rowell was going to change his position
4 from design and construction flaws to there is just
5 something excessive or unreasonable about building a
6 plant in one year and a few years later fixing it, then
7 maybe we would have called somebody different earlier.

8 But when you asked Mr. Rowell the other day was
9 his position at this point simply a layman's reading of
10 operational challenges and the need for the upgrades and
11 his view that the magnitude of it inherently suggests
12 something wrong, that's a change in his position. And
13 we are bringing the witness in to rebut it.

14 We didn't have any prior notice that he intended
15 to change his position. We have, in fact, given RUCO as
16 much notice as we can by filing his summary. And we had
17 informed the parties two days ago, and Ms. Woods
18 e-mailed an objection at that time. We asked them to
19 elaborate. And the first thing we heard from RUCO since
20 then is today.

21 MS. WOOD: Your Honor, I will quote from
22 Mr. Rowell's direct testimony: It is inherently unfair
23 to saddle customers with the excess and duplicative
24 costs that result when utilities fail in that
25 obligation.

1 ACALJ NODES: Hold on. You need to slow down.
2 The court reporter can't transcribe. Go ahead.

3 MS. WOOD: The initial testimony that Mr. Rowell
4 gave on direct, which was filed, I believe, in November,
5 is that it is inherently unfair to saddle the customers
6 with the excess and duplicative costs. That's on page 5
7 of his direct testimony. This isn't a new argument, it
8 is the same old argument, and they have been well aware
9 of it.

10 In response to that they incorporated in
11 rebuttal testimony the testimony of Mr. McBride. We
12 have had notice of the testimony of Mr. McBride. We
13 have had an opportunity to effectively cross-examine
14 him. If they want to bring Mr. McBride back on
15 rebuttal, or, excuse me, as part of a rebuttal case to
16 provide oral testimony, we don't have an objection to
17 that.

18 We do have an objection to a new witness whose
19 testimony we have never seen. The fact that they
20 provided a summary is not the same as what they said
21 they would do, which was to provide, before close of
22 businesses yesterday, his testimony. We don't have any
23 testimony.

24 And we did respond to the company. And our
25 response is we don't have an objection to a rebuttal

1 case. We have an objection to the introduction of a new
2 witness who we have never had an opportunity to file
3 rebuttal testimony to or direct testimony. We have not
4 been able to participate in the same process to the same
5 extent that they are planning to do through the rebuttal
6 through an absolutely new witness.

7 ACALJ NODES: Okay. Well, just let me ask you
8 one question. If it is going to be oral rebuttal, what
9 difference does it make whether it is an existing or
10 prior witness, or whether it is an entirely different
11 witness? You are not going to know what the witness is
12 going to say orally until you actually hear it. So in
13 that sense what difference does it make?

14 MS. WOOD: The order says that any witness --
15 the procedural order says any witness intended to
16 testify during these proceedings will file prefiled
17 testimony so that we all have the same opportunity to
18 effectively cross-examine opposing witnesses. That's
19 the procedural order.

20 I asked for an extension of some of the time
21 periods in the procedural order on behalf of RUCO and I
22 was denied, flat out, twice, and I accepted it. Now,
23 the same guidelines in a different section also apply to
24 the company. I don't understand why the company is
25 afforded the opportunity to violate the terms of that

1 procedural order and the timelines, but RUCO wasn't
2 afforded a one-week continuance. I don't think it is
3 fair and I think it is preferential. I think they had
4 an opportunity to file prefiled testimony. They can use
5 the witnesses they used for prefiled testimony, or not.

6 ACALJ NODES: Well, you didn't answer my
7 question. What is the difference between oral testimony
8 from a prior witness as opposed to a different witness?

9 MS. WOOD: A different witness has -- I don't
10 have the opportunity in less than 24 hours to research a
11 new witness to find out what his bias and prejudice
12 might be, his perspective, his background. I have no
13 way to impeach him. I am not that good.

14 ACALJ NODES: Okay. Mr. Shapiro.

15 MR. SHAPIRO: Well, first all, let me just
16 correct the record. Ms. Wood was never promised
17 Mr. Jones' prefiled testimony. She was promised a
18 summary and resumé, which I believe were provided
19 yesterday.

20 Second of all, we have the burden of proof in
21 this case. We have a right to call rebuttal witnesses
22 and to limit their rebuttal to issues that were raised
23 during the trial. That's all we intend to do.

24 This is not uncommon. It is certainly not
25 unlawful. It is not inappropriate. It may not be

1 frequent, but I have been doing rate cases before this
2 Commission for over a decade and a half, and we have a
3 right to a rebuttal case. We have given them as much
4 notice as we can of what we intend to do.

5 And, you know, as Ms. Wood did with Mr. McBride,
6 she can, through cross-examination, explore Mr. Jones'
7 biases, prejudices, and anything else that's appropriate
8 and relevant to this case.

9 ACALJ NODES: Okay. Staff have anything they
10 want to say about this issue?

11 MS. MITCHELL: Staff doesn't object to the
12 company's presentation of Mr. Jones as a rebuttal
13 witness. And frankly we don't really have a dog in this
14 fight. So I will just let them duke it out and you will
15 decide what you decide. But Staff doesn't have any
16 objection to the presentation of Mr. Jones.

17 MS. WOOD: I would comment, Your Honor, the only
18 person in the room who has or is at issue with the
19 witnesses, the testimony from the engineering
20 perspective, is RUCO, who has questions that they have
21 raised about Mr. McBride's position and position of the
22 company. There isn't anybody else in the room who is
23 even on the same side as the company.

24 ACALJ NODES: Okay. Is the city -- are you with
25 the city, sir, representing the city with Mr. Sullivan's

1 firm?

2 MR. UDALL: Yes. Mr. Sullivan is out of town,
3 asked me to sit in his place. We don't have a position
4 at this time.

5 ACALJ NODES: Can you just identify yourself.

6 MR. UDALL: Yes. I am sorry. Larry Udall with
7 the same firm.

8 ACALJ NODES: Okay, welcome, Mr. Udall. Thank
9 you.

10 Well, you know, here is what I am going to do.
11 I am going to allow the company to go forward with the
12 rebuttal witness. And then I will make a decision at
13 the time. If it appears that there needs to be
14 additional preparation based on something that is raised
15 during the rebuttal case, I will take arguments, and we
16 will see if we need to come back, but --

17 And Ms. Wood, one of the comments that kind of
18 disturbed me is that it seems as though you were
19 suggesting I am giving preferential treatment to the
20 company. And you know, I have heard rate cases for more
21 than 20 years, and it has routinely been allowed that
22 the company, bearing the burden of proof, has the final
23 say. And the opportunity to prepare, I have always
24 allowed an ample opportunity to parties to prepare. But
25 it is -- I have had in many, many cases oral rebuttal

1 offered by the company, and I really don't think there
2 is a relevant distinction if the oral testimony is
3 offered through a witness who has already appeared or
4 not. So that's how we will proceed. And we will see
5 how things go.

6 All right. Anything else preliminary?

7 (No response.)

8 ACALJ NODES: All right. I think we are ready,
9 Ms. Mitchell, for your, I guess, first witness, even
10 though we took one out of order partially.

11 MS. MITCHELL: That's correct. Staff would call
12 Marlin Scott.

13

14 MARLIN SCOTT, JR.,

15 called as a witness on behalf of ACC Staff, having been
16 first duly sworn by the Certified Reporter to speak the
17 truth and nothing but the truth, was examined and
18 testified as follows:

19

20 DIRECT EXAMINATION

21 BY MS. MITCHELL:

22 Q. Good morning, Mr. Scott. Could you please state
23 your name and business address for the record.

24 A. My name is Marlin Scott, Jr. My business
25 address is the Arizona Corporation Commission, 1200 West

1 Washington, Phoenix, Arizona 85007.

2 Q. And what is your position with the Arizona
3 Corporation Commission?

4 A. I am a utility engineer.

5 Q. And could you briefly describe your duties in
6 that position.

7 A. As a utility engineer I evaluate or provide
8 technical assistance in rate cases, financing,
9 certificates of convenience and necessity, extensions,
10 and at times also on complaint cases.

11 Q. Thank you.

12 And in the course of your employment were you
13 assigned to review and evaluate the rate application of
14 LPSCO?

15 A. Yes.

16 Q. And did you prepare and prefile any testimony
17 for this case?

18 A. Yes.

19 Q. You have in front of you what has been marked as
20 Staff Exhibit S-5. Could you please identify that for
21 the record.

22 A. S-5 is my direct testimony dated November 4th,
23 2009.

24 Q. And do you have any additions, corrections, or
25 modification to make to S-5?

1 A. No.

2 Q. All right. And I think you have also in
3 front -- oh, and do you adopt S-5 as your sworn
4 testimony today?

5 A. Yes.

6 Q. You also have in front of you what has been
7 marked as Staff Exhibit S-6. Could you please identify
8 that for the record.

9 A. S-6 is my surrebuttal testimony dated
10 December 17th, 2009.

11 Q. And do you have any additions, corrections or
12 modifications to make to S-7?

13 A. No.

14 Q. Or 6. What number am I on? 6?

15 A. 6.

16 Q. Do you adopt S-6 as part of your sworn testimony
17 here today?

18 A. Yes.

19 MS. MITCHELL: Your Honor, at this time I would
20 like to move for the admission of S-5 and S-6.

21 (No response.)

22 ACALJ NODES: S-5 and S-6 are admitted.

23 (Exhibits S-5 and S-6 were admitted into
24 evidence.)

25 MS. MITCHELL: Thank you.

1 BY MS. MITCHELL:

2 Q. I want to ask a couple of questions concerning
3 the plant capacity and odor issues with LPSCO. Did you
4 conduct an investigation into odor problems experienced
5 by LPSCO in Docket 06-044?

6 A. Yes, I did.

7 Q. And did you prepare a Staff -- a number of Staff
8 reports summarizing the results of the investigation?

9 A. Yes.

10 Q. I want to show you, I guess, the first Staff
11 report that was authored by you and issued in that
12 docket.

13 Your Honor, I am just going to pass out a
14 report.

15 I have given you what I have marked as Staff's
16 Exhibit S-7. Could you identify that for the record.

17 A. S-7 is my first, or Staff's first compliance
18 Staff report for Docket No. 06-0444 which is dated
19 October 4th, 2006.

20 Q. And could you just basically summarize the
21 content of that report.

22 A. Well, first of all, this report was a request
23 from the Commissioners on odor problems that started to
24 occur for this water -- for this company. This report
25 just discusses a field visit to the Palm Valley

1 reclamation facility. And we reported that we detected
2 the skunky odor, and that was one item that we reported.
3 The other items that we reported was the company's plan
4 of action on how to resolve the odor issue. And another
5 item that was under discussion was increasing the plant
6 capacity. And there was three options that the company
7 was evaluating.

8 And one thing I would note is on the first
9 page on the last paragraph it states that the odor
10 control equipment was undersized, which was
11 approximately one-third the capacity. And based on
12 that, it appeared that the odor issues was being caused
13 from undersizing of the odor control systems.

14 MS. MITCHELL: All right. Thank you.

15 And Your Honor, I just looked at this exhibit,
16 since I make my own exhibits, and I put two reports
17 together, which the second report needs to be unhooked
18 from this exhibit because I am going to offer it
19 separately, and because the first report is only four
20 pages.

21 ACALJ NODES: I see.

22 MS. MITCHELL: So everything beyond the four
23 pages, if everybody could just unattach that, I would
24 appreciate it. Thank you.

25 ACALJ NODES: Okay. Does everyone understand

1 the request to detach the first four pages from the
2 second four pages, I guess?

3 All right. And so the second four pages you are
4 going to offer as a separate exhibit?

5 MS. MITCHELL: Maybe.

6 ACALJ NODES: Oh, okay.

7 MS. MITCHELL: Maybe.

8 ACALJ NODES: You will keep us in suspense.

9 MS. MITCHELL: Yes, I am. There is just so much
10 paper floating around here I get confused.

11 BY MS. MITCHELL:

12 Q. And did Staff continue to monitor the situation
13 at LPSCO pursuant to this docket?

14 A. Yes. During the course of our monitoring, I
15 visited the site a couple times with our consumer
16 service representatives. And in fact, my immediate
17 supervise, Del Smith, did some site visits along with
18 our director, Steve Olea.

19 Q. All right. And did you prepare another
20 compliance filing for this docket?

21 A. Yes.

22 MS. MITCHELL: All right. Here I come again
23 with Staff Exhibit S-8.

24 (Brief pause.)

25 ACALJ NODES: I am confused now. When we

1 detached the second set, that's not going to be an
2 exhibit?

3 MS. MITCHELL: Yes. I am going in chronological
4 order.

5 ACALJ NODES: I got you. I apologize.

6 MS. MITCHELL: That's okay. You are just a
7 little ahead of me.

8 (Brief pause.)

9 BY MS. MITCHELL:

10 Q. Mr. Scott, I have given you what I have marked
11 as Exhibit Staff S-8. Could you identify that for the
12 record, please?

13 A. S-8 is a Staff report dated October 18th, 2007
14 for Docket No. 06-0444.

15 Q. And could you describe what is in this Staff
16 report.

17 A. This report was in response to Commissioners'
18 requests to initiate an OSC investigation. And this
19 report begins by stating that Staff was going to collect
20 data and report back to this docket number on their
21 findings.

22 Q. All right. And within this Staff report do you
23 discuss the capacity at the time that you conducted this
24 particular investigation, do you discuss plant capacity?

25 A. Yes. That was discussed on page 3 under the

1 topic of plant capacity, which at that time it was
2 currently at 4.1 million gallons per day.

3 Q. All right. And did Staff continue to do some
4 monitoring past, subsequent to this Staff report in this
5 particular docket, 06-0444?

6 A. Yes, we did.

7 Q. I have another report that I am going to show
8 you.

9 And Your Honor, that's the one that was attached
10 to the first exhibit. Do you need another copy?

11 ACALJ NODES: No.

12 MS. MITCHELL: It would just be confusing. I am
13 going to mark this as S-9.

14 BY MS. MITCHELL:

15 Q. Mr. Scott, could you identify the document I
16 just handed you for the record, please.

17 A. S-9 is the final Staff compliance report for
18 Docket No. 06-0444, which is dated March 21st, 2008.

19 Q. If you could, turn with me to page 2 of this
20 report.

21 A. Okay.

22 Q. And the next to the last sentence on that page,
23 can you read that last sentence. It is the next to the
24 last sentence on that page, the next to the last
25 sentence. It starts with Staff.

1 A. I am going to read the last sentence.

2 Q. Okay.

3 A. Yes, second to last sentence. It says Staff
4 also noticed a musty smell, parenthesis, on plant
5 property, unparenthesis, during the tour, but
6 contributed this smell due to the PVWRF being under
7 construction to increase the plant capacity by
8 1 million gallons per day.

9 Q. Was there really an expansion of 1 million
10 gallons per day going on at the time you did this
11 investigation for this report?

12 A. At the time during this investigation there was
13 a possibility of, and one of the options was, to
14 increase the plant capacity by one million gallons per
15 day at the same site, but that did not occur. And if I
16 was to rewrite that sentence today, I would reword it
17 differently.

18 Q. Thank you.

19 And did Staff request that a docket be opened to
20 inquire into the operational practices of LPSCO.

21 A. Yes.

22 Q. And the docket number, if I am correct, is
23 07-0602?

24 A. Yes.

25 Q. And did you prepare a Staff report for inclusion

1 within that docket?

2 A. Yes. I provided a number of Staff reports.

3 Q. I am going to show you what I have marked as
4 Staff Exhibit S-10.

5 (Brief pause.)

6 BY MS. MITCHELL:

7 Q. Mr. Scott, could you identify this for the
8 record, please.

9 A. Yes. This is a Staff report for Docket
10 No. 07-0602 dated March 11th, 2009.

11 Q. And did you prepare this Staff report?

12 A. Yes.

13 Q. And if you could, turn with me to page 2 of this
14 report.

15 A. Yes.

16 Q. Do you discuss treatment capacity?

17 A. Yes.

18 Q. And what did you note at the time of this report
19 was the current plant capacity at Palm Valley?

20 A. On page 2, the bottom paragraph, I stated that
21 the current plant capacity was 4.1 million gallons per
22 day.

23 Q. So would it be safe to say that the current
24 capacity as of March 2009 was 4.1 million gallons per
25 day?

1 A. Yes.

2 Q. Thank you.

3 One more exhibit. Did you discuss with the
4 company, particularly Mr. Sorensen, the need for a
5 pretreatment tariff?

6 A. Well, the discussion of a pretreatment tariff
7 began back in 2008 when the company filed an approval,
8 they called it back then a new code of practice tariff,
9 which we just referred to as a pretreatment tariff. And
10 we went through a process where that docket number was
11 not completed in time due to statutory limits, I think
12 like 300 day complete tariff filing was not met. So the
13 Commission denied that tariff request. And that's
14 the -- that's a little summary on the pretreatment
15 tariff.

16 Q. And what is the purpose of a pretreatment
17 tariff?

18 A. Basically it is just to more or less police
19 commercial, industrial customers to make sure that there
20 is certain waste that should not go into the collection
21 system of the company. If that happens, then they have
22 difficulty in treating their wastes at their plant.

23 Q. And did you prepare a summary of what you would
24 expect to see in such a tariff?

25 A. Yes.

1 Q. I am going to show you what I have marked as
2 Staff Exhibit S-11.

3 (Brief pause.)

4 BY MS. MITCHELL:

5 Q. Could you identify S-11, please.

6 A. S-11 is a supplement to my testimony for the
7 requests for a pretreatment tariff.

8 MS. MITCHELL: Your Honor, at this time, I would
9 like to move for the admission of S-7, S-8, S-9, S-10,
10 and S-11.

11 ACALJ NODES: Any objections to those exhibits?

12 (No response.)

13 ACALJ NODES: S-7 through 11 are admitted.

14 (Exhibits S-7 through S-11 were admitted into
15 evidence.)

16 MS. MITCHELL: I have no further questions for
17 Mr. Scott. He is available for cross-examination.

18 ACALJ NODES: Okay.

19

20 EXAMINATION

21 BY ACALJ NODES:

22 Q. Mr. Scott, just a point of clarification on
23 S-10.

24 A. Yes.

25 Q. This is the Staff report in the separate docket

1 opened to monitor the company's operational practices,
2 correct?

3 A. Yes.

4 Q. Now, in this Staff report you indicate that the
5 company, at least as of the date of the report, had not
6 responded to a Staff data request on a certain issue,
7 and that you recommended the docket remain open and that
8 Staff would update the docket once the data request
9 responses are received and reviewed by Staff. Did that,
10 in fact, occur, both the responses being received and a
11 subsequent update by Staff in this docket?

12 A. Yes. This March 3rd report is Staff's second
13 report. There is a third report.

14 Q. Wait a minute. This one was March 11th?

15 A. Yes, which is, I am just saying it is Staff's
16 second report.

17 Q. Okay.

18 A. And there is another third report that's after
19 this --

20 Q. Okay.

21 A. -- the same docket number, which was docketed on
22 November 12th, 2009. In that report I state that these
23 two requested items that we requested was fulfilled by
24 the filing of the rate case. In this rate case the
25 company provided the items that I requested related to

1 the service laterals and plant capacity, and based on my
2 testimony for this rate case, I stated that the company
3 has sent that information.

4 ACALJ NODES: Okay. Thank you.

5 All right. Mr. Udall, do you have any questions
6 for Mr. Scott?

7 MR. UDALL: No, I do not, Your Honor.

8 ACALJ NODES: Okay, thank you.

9 Mr. Wiley.

10 MR. WILEY: Sorry, Judge, just a couple
11 questions. And I also have a little bit of a bug today
12 so bear with me and my voice, please.

13

14 CROSS-EXAMINATION

15 BY MR. WILEY:

16 Q. Mr. Marlin Scott, Mr. Scott, the company has
17 submitted a financing application which you addressed in
18 portions of your direct and surrebuttal testimony,
19 correct?

20 A. Yes.

21 Q. Okay. And part of that financing application
22 was for \$1.755 million for a recharge well project which
23 involves recharging effluent into the aquifer, right?

24 A. Yes.

25 Q. Okay. If the company -- and I believe that the

1 initial project was intended to be an injection well for
2 the effluent. Do I have that right?

3 A. Yes. It was two injection wells.

4 Q. If the company invests the implementation of
5 those injection wells, and based upon the soil
6 conditions that exist at the site or other conditions,
7 would Staff have any objection if the company used that
8 \$1.755 million in debt on another effluent recharge
9 project that involves different methodologies for
10 recharging the effluent?

11 A. For me to answer that I would state that the
12 costs, would they be similar, what type of method. And
13 if it is similar to the injection wells and if it is a
14 replacement for this financing, then I wouldn't object.
15 But it is just what type of method are you referring to.

16 Q. Would it be fair to say, Mr. Scott, that if the
17 debt on a different recharge methodology remained the
18 same, Staff would have no objection as long as the
19 company provided you information on exactly what the
20 project entailed, is that fair?

21 A. Yes.

22 Q. And as long as the company gave you an
23 opportunity to comment on that, that would be sufficient
24 for you and Staff?

25 A. That would be sufficient, yes.

1 FURTHER EXAMINATION

2 BY ACALJ NODES:

3 Q. Well, Mr. Scott, on that issue, would -- is
4 there a chance that WIFA might have an issue if the
5 project changed from what was being initially considered
6 for the purposes of the loan?

7 A. I think if, just as long as it is a recharge
8 project, I took it as it is a different type of method,
9 so as long as it is a recharge project, it would still
10 be under WIFA's review. And if -- might -- I would
11 think that if WIFA states that or receives information
12 from the company that they decide to change their method
13 of the recharge, then I don't see any difficulty in WIFA
14 accepting that type of method.

15 Q. Okay. Your understanding is WIFA doesn't --
16 typically wouldn't have a concern with the level of
17 detail that Staff might take into consideration
18 regarding the project?

19 A. No. And knowing an engineer at WIFA, I think he
20 might. Sometimes he is a little more detailed.

21 Q. Okay.

22 A. But bottom line is we talk on other cases and we
23 share our thoughts with applications like this. And
24 sometimes he has the same concerns as Staff does.

25 Q. Okay. Well, I guess I am still -- okay. Back

1 to procedurally, though, how this is, assuming what
2 Mr. Wiley suggested might occur, how is this all going
3 to unfold?

4 I mean, if Staff makes a recommendation
5 regarding a specific project and the underlying
6 engineering aspects of the project for purposes of the
7 financing, and then it later turns out that the company
8 uses a different methodology with different costs, but
9 the Commission has already approved the financing based
10 on the first set of assumptions, does Staff then have to
11 make some updated recommendation and the Commission then
12 has to enter a subsequent approval for those, the
13 updated project assumptions? I mean, how do you
14 envision that occurring?

15 A. One way would be to put it back on the company.
16 If the company wants to continue on this schedule, they
17 should provide that information to this docket for
18 review. And we can determine to see what the actual
19 costs, amounts would be, and if it is still reasonable.

20 Q. Okay. Is one alternative perhaps some
21 preemptive kind of language in the Commission's order
22 that would allow some variance from the specifics that
23 are in the record, as long as Staff subsequently looks
24 at it and is satisfied with the alternative that is
25 presented?

1 A. Yes, that could be another option.

2 Q. Okay. Rather than having to go through another
3 whole round of proposal by the company, Staff review,
4 Staff report, and a Commission order?

5 A. Yes.

6 Q. And would it be your preference that the former,
7 i.e., the broader scope included in this order, would be
8 preferable to having to go through all the other reviews
9 and approvals?

10 A. Yes, that sounds reasonable.

11 ACALJ NODES: Okay. All right. Thank you.

12 Ms. Wood.

13 MS. WOOD: Thank you, Your Honor.

14

15 CROSS-EXAMINATION

16 BY MS. WOOD:

17 Q. Good morning, Mr. Scott.

18 A. Good morning.

19 Q. You indicated that part of the odor issues was a
20 result of the odor control equipment being undersized,
21 correct?

22 A. The odor control system, yes.

23 Q. And this is a completely unrelated question, but
24 would you accept subject to check that the conversion of
25 gallons per minute to gallons per day is 1,140?

1 A. Yes.

2 Q. Would you also agree that reliability and
3 redundancy requirements can be met by designing a single
4 treatment process with parallel piping and equipment
5 which provides full redundancy, for example, main or
6 standby process unit or units or equipment?

7 A. I am not understanding your question.

8 Q. Maybe I can restate it again. Would you agree
9 that the reliability and redundancy requirement can be
10 met by designing a single treatment process with
11 parallel piping and equipment which provides full
12 redundancy and, for example, a main system with a
13 standby process unit, units, or equipment?

14 A. For wastewater?

15 Q. Yes.

16 A. That's a loaded question for a wastewater; I
17 mean, there is a lot of components. It could be a
18 possibility on the water side, but on the wastewater
19 side, there is -- it is difficult to say, for me to say
20 right now.

21 Q. Would you also, would you agree that the rated
22 capacity of a wastewater treatment plant is based on the
23 firm capacity of the facility?

24 A. To me it is based on the aquifer protection
25 permit that's authorized to maintain and operate this

1 plant.

2 Q. Well, can you distinguish that -- in the process
3 of obtaining a permit, you have to have equipment rated,
4 correct?

5 A. You would have to show to the regulatory
6 agencies that what you built should operate at a safe
7 and adequate manner.

8 Q. Correct. And part of that process is
9 establishing a rating for the equipment, correct?

10 A. Firm capacity is one term that the agency, DEQ,
11 Maricopa County uses.

12 Q. And firm capacity is the rating capacity that a
13 wastewater treatment plant is based upon, the firm
14 capacity of the facility?

15 A. That's not correct.

16 Q. Okay. What do you think it is based upon?

17 A. Firm capacity is based on different components
18 of the wastewater facility, like, for example, the pump.
19 It is really based on the pumping capacity. If one pump
20 goes out, then maybe two or three others that are in
21 operation, that's your firm capacity.

22 Q. I understand the term firm capacity. Thank you
23 for clarifying that. But my question was not what is
24 the definition of firm capacity. My question was: The
25 rating of a plant, when you are trying to achieve a

1 permitted level, the rating that you present is based in
2 part upon the firm capacity that you can demonstrate by
3 using the equipment that you are putting forth for your
4 permit, correct?

5 A. If I read the APP correctly, it is based on the
6 average daily demand.

7 Q. Okay. Well, again, I am not asking you about
8 permitted capacity, and I am not asking you about the
9 definition of firm capacity. What I am trying to get
10 from you is the definition of rating. How do you
11 establish a rating for equipment? Is it based in part
12 on the firm capacity of that equipment?

13 A. Okay. I understand what you are -- your
14 question. Yes. You could say that a plant or a pump
15 has a rating of a thousand gallons a minute, but it
16 could be operating less than that.

17 Q. Correct. Thank you.

18 Can you explain the difference between capacity
19 and redundancy or can you just define what redundant
20 capacity means?

21 A. To me redundancy means duplicated plant
22 facilities constructed and operated in case there is a
23 failure on your, on your system.

24 Q. And how much redundant capacity is needed for a
25 wastewater plant rated at 4.1 MGD?

1 A. If the plant is 4.1, did you say?

2 Q. Yes.

3 A. It could be up to 4.1 or it could be less than
4 that.

5 Q. And when is the less than that permitted?

6 A. Well, give you an example. For this treatment
7 method, call it SBRs, there is, since it was modified,
8 there is three SBRs now. Two are at 1.5, and the last
9 one is at 1.1. So when I say redundancy, that redundant
10 capacity, that's the 1.1 that was modified to help the
11 redundant capacity for this plant.

12 Q. In an aquifer protection permit they have alert
13 levels, correct?

14 A. They have, yes, quite a few levels, depending on
15 the allowable limits.

16 Q. Is it true that by the time the average day
17 maximum monthly flow to a wastewater treatment plant
18 reaches 80 percent of the facility rated capacity, the
19 owner may initiate or should initiate planning and
20 design of the next expansion of the facility?

21 A. Yes. That rule of thumb, that 80 percent
22 capacity is when a plant reaches 80 percent of that
23 capacity, they are required to send their plans to
24 Maricopa County or DEQ.

25 Q. And it is based on the average day maximum

1 monthly flow, correct?

2 A. Yes.

3 Q. In the documentation that you reviewed in
4 preparation of this matter did you actually look at the
5 DEQ documents?

6 A. Are you referring to the upgrades?

7 Q. Yes.

8 A. No, I did not.

9 Q. Okay. Now, I noticed in your reports that we
10 just received it references a Phase 11. Can you tell us
11 what Phase 11 is?

12 A. Phase 11 is the chlorination and dechlorination
13 units that were phased as Phase No. 11.

14 Q. And what was the nature of the work?

15 A. My understanding was this will help disinfect
16 the effluent going out to -- off the property of the
17 wastewater treatment plant.

18 Q. So it is a chemical process?

19 A. Yes, it is chlorine, yes. You chlorinate it,
20 and before you dump it you got to dechlorinate it to
21 meet your permits.

22 MS. WOOD: Okay. I won't use the word futile,
23 but yes.

24 I don't have any further questions of Mr. Scott
25 at this time.

1 ACALJ NODES: All right. Any redirect?

2 MS. MITCHELL: Just a little bit.

3

4 REDIRECT EXAMINATION

5 BY MS. MITCHELL:

6 Q. Mr. Scott, in some questions from Mr. Wiley and
7 Judge Nodes concerning the company's change in
8 methodology relative to the findings in the application,
9 would it be safe to say that your yes, that it would
10 probably be okay is more of a qualified yes, depending
11 on the information that Staff receives from the company?

12 A. Yes. That's a better answer.

13 MS. MITCHELL: All right. I don't have anything
14 else. Thank you.

15 ACALJ NODES: Thank you.

16 Mr. Wiley, any further questions?

17 MR. WILEY: Just a couple, Judge.

18

19 RECROSS-EXAMINATION

20 BY MR. WILEY:

21 Q. Mr. Scott, Ms. Wood was asking you questions
22 about redundant treatment capacity. Do you recall that
23 question?

24 A. Yes.

25 Q. And I think you mentioned that redundant

1 treatment capacity is essentially duplicative parts of
2 the system that are used for emergencies or some sort of
3 situation like that, correct?

4 A. Correct.

5 Q. Would that also include routine maintenance on
6 the facilities, so, for example, when you are looking at
7 the SBR reactors, the third SBR reactor could be used
8 while one of the other two primary reactors was taken
9 out of service for maintenance and operational issues
10 such as maintenance and operations?

11 A. Yes.

12 Q. Is that fair?

13 A. Yes. That's one of the main reasons, also.

14 Q. Okay. And is it also your understanding that
15 the APP for the Palm Valley facility is based upon the
16 maximum monthly average daily flows?

17 A. Yes.

18 MR. WILEY: Okay. I have no more questions,
19 Judge.

20 ACALJ NODES: Ms. Wood, anything further?

21 MS. WOOD: I do, Your Honor. And it will just
22 take me one minute to find the exhibit.

23 ACALJ NODES: Okay.

24

25

1 RE CROSS-EXAMINATION

2 BY MS. WOOD:

3 Q. I can ask it this way. What do you believe the
4 maximum average monthly flow to be at the plant? Is it
5 4.1 or 8.2?

6 A. Well, during the test year it ranged -- it is
7 different during the year to year. I could give you an
8 answer based on the test year.

9 Q. Sure.

10 A. If you go to my direct testimony, S-5, page 29
11 of 33, it would be Figure C-1. And the peak average
12 daily would be 3.3 -- oh, I am sorry. It is 3.4 in
13 November of '07.

14 MS. WOOD: Okay. Thank you.

15 ACALJ NODES: Anything further, Ms. Mitchell?

16 MS. MITCHELL: No, Your Honor.

17 ACALJ NODES: Mr. Wiley, anything further?

18 MR. WILEY: Just real quick, if I can find the
19 hearing exhibits.

20

21 FURTHER RE CROSS-EXAMINATION

22 BY MR. WILEY:

23 Q. Can I have you look at A-36 up there, Mr. Scott.

24 A. I have it.

25 Q. And if you turn to the second page of that

1 exhibit, that shows the average MGDs per month from
2 October of '08 through September of '09, correct?

3 A. Yes.

4 Q. Okay. And the peak maximum month there was
5 3.495 average MGD for the month, correct?

6 A. Yes. That was November of '08.

7 Q. Right. And that's over 85 percent of the rated
8 capacity of the plant, agreed? And I will tell you the
9 3.495 divided into 4.1 yields that 85.2 percent.
10 Assuming that's true, that would be 85 percent of the
11 capacity, agreed?

12 A. I will agree with that.

13 Q. Okay. And you also agree that there is no
14 excess capacity at the Palm Valley reclamation facility
15 as it sits there today, agreed?

16 A. I will agree with that.

17 MR. WILEY: Okay. No more questions, Judge.

18 ACALJ NODES: Ms. Wood, anything further?

19 MS. WOOD: Yes.

20

21 FURTHER RECROSS-EXAMINATION

22 BY MS. WOOD:

23 Q. When you are talking about 85 percent of the
24 plant's capacity, you are talking about the plant's
25 permitted capacity, is that what you are saying,

1 Mr. Scott?

2 A. Yes, of the 4.1.

3 Q. And although you are saying the permitted,
4 within the permit currently there is no excess capacity;
5 isn't it true that the some of the components of the
6 plant have been expanded? Let me break it down into two
7 questions.

8 Is it true that some of the components of the
9 plant have been expanded?

10 A. They have been modified to meet a third SBR
11 plant. And if your term expanded means you are
12 expanding the SBR, the third plant, I would say yes.

13 Q. Okay. And let me look specifically at the -- do
14 you have Exhibit R-3 in front of you?

15 A. Yes.

16 Q. Turn to page 205.

17 A. Okay.

18 Q. You agree that what is indicated there is the UV
19 system has been upgraded to 15.76 MGD?

20 A. What paragraph?

21 Q. Well, I am looking at the introduction.

22 A. Yes, the UV has been improved.

23 Q. And the capacity is 15.76 MGD, correct?

24 A. Did you say 15.7?

25 Q. 15.76 is what I said.

1 A. I don't see that anywhere.

2 Q. Looking at the first sentence, excuse me, the
3 first paragraph, last sentence, it says the UV system
4 now consists of two new treatment trains each with a
5 capacity of 5 MGD, correct?

6 A. Yes.

7 Q. So that would be 10 MGD, correct?

8 A. Yes.

9 Q. And for existing UV units each with a capacity
10 of 1.44 MGD, correct?

11 A. Yes.

12 Q. When you add that would you accept, subject to
13 check, that that is 15.76 MGD?

14 A. That would be the total, but that's not how it
15 operates.

16 Q. But that would be the total amount of plant that
17 the ratepayers are being asked to compensate or pay for,
18 pay a return on?

19 A. Yes, because the old UV, the way I understand
20 it, it was put -- it is on standby.

21 Q. Correct.

22 A. Yes.

23 Q. Okay. So you said that the current average
24 monthly flow of the plant was 4.1, correct?

25 A. Yes.

1 Q. And redundancy would be up to 4.1 or less than,
2 correct?

3 A. For certain parts of the plant.

4 Q. Correct. Okay. So that's 8.2, correct?

5 A. What is 8.2?

6 Q. 8.2 would be the amount currently permitted plus
7 the amount you said you would need at about two 4.1 for
8 redundancy, or am I misstating your testimony? You can
9 clarify if it is.

10 A. Well, you are talking about all these
11 capacities, but like I said, if you are going to talk
12 capacity, you have got to throw in the term firm
13 capacity, because some of these components are designed
14 to meet the firm capacity that's approved by Maricopa
15 County.

16 Q. Okay. So the firm capacity for this, throwing
17 out the largest segment, would be the 5 MGD, and
18 retaining the four existing UV facilities of 1.44 plus
19 one of the 5 MGD, that would still be over 10.76 MGD for
20 firm capacity, correct?

21 A. That's not correct.

22 Q. Okay. Then explain to me what the firm capacity
23 of the UV disinfection system is.

24 A. You have got to take both UV separately, the new
25 unit and the old unit. You got to, based on how they

1 operated. The new one is in operation, the old one is
2 on standby. So when you are talking about capacity, you
3 got to separate the flows, because that's not normal
4 operation today.

5 Q. What is -- how do you define the firm capacity,
6 or how do you arrive at the firm capacity for the UV
7 disinfection system?

8 A. If you have one or two, and if one goes down,
9 the other two, that would be your firm capacity. That
10 means those are in operation to treat the flow.

11 Q. Isn't firm capacity determined after putting the
12 largest unit down, what is left to cover the process?

13 A. That's what I said, yes.

14 Q. So the largest unit here is one of the two 5 MGD
15 plants, correct?

16 A. Yes.

17 Q. Okay. So what we have left after that is a
18 5 million gallon per day plant that's one of the new
19 systems, and four existing UV systems that are on
20 standby, correct?

21 A. I am not following you. You are mixing the
22 treatment capacity with the UVs, and I am having
23 difficulty trying to understand or give you a good
24 answer on what you are trying, trying to ask.

25 Q. Well, why don't you tell me, what is the firm

1 capacity of the UV disinfection system?

2 A. There are two brand new UVs, so if one goes
3 down, the firm would be 5.

4 Q. Okay. So you have redundancy established for
5 this 4.1 MGD plant by the use of two UV disinfection
6 units that are at 5 MGD, correct?

7 A. Could you repeat that.

8 MS. WOOD: Actually, if you could read it back,
9 that would be helpful.

10 (The record was read by the reporter as
11 requested.)

12 THE WITNESS: When the company installed their
13 new UV, the redundancy was the old UV. That's what is
14 redundant now. It is the backup.

15 BY MS. WOOD:

16 Q. Okay. So would that then refer to the four UV
17 facilities that are in backup that are at 1.44 each?
18 And I mean 1.44 MGD each.

19 A. Yes.

20 Q. Okay. So are you asserting then that -- let me
21 clarify.

22 This new treatment for UV disinfection consists
23 of two trains, yes?

24 A. For the UVs.

25 Q. Two different trains, correct?

1 A. Yes.

2 Q. And one train ostensibly for the 4.1 MGD plant
3 could ostensibly serve as a backup for the other 5 MGD
4 plant, correct?

5 A. It is not quite that simple.

6 Q. Okay. Why don't you explain to me.

7 A. From an operational standpoint, you have got to,
8 you have got to operate it going in one UV unit, or if
9 you are going to take it down, you switch flows to the
10 other unit. You don't separate the flows in each. It
11 is either one or the other.

12 Q. Okay. So the way that this plant works is only
13 one UV train is in use at a time?

14 A. You may alternate it.

15 Q. I am not, I am not suggesting you can't, but are
16 you saying you don't separate the flows through each
17 5 UV MGD system, but the flows, if they are going
18 through, go through one at a time, is that correct?

19 A. You could do that or you could flow in both
20 units.

21 Q. Okay. But for 4.1 MGD do you need to?

22 A. I would say yes.

23 Q. Okay. Why?

24 A. In case one of the new ones go down.

25 Q. So you would use them both at the same time if

1 one was down, or you would use one -- we will call it
2 unit 1 and unit 2. If unit 1 goes down, you could use
3 unit 2, is that what you are saying?

4 A. If it was me, I would operate it once in awhile
5 or all the time to make sure it was working in case
6 there was an emergency that happens I would have that
7 backup and I know it is in operation.

8 Q. And then you would also have as backup the other
9 5.76 MGD four standby units?

10 A. Yes.

11 MS. WOOD: Okay. Thank you.

12 ACALJ NODES: Mr. Wiley, anything further?

13 MR. WILEY: Just one, Judge.
14

15 FURTHER RECROSS-EXAMINATION

16 BY MR. WILEY:

17 Q. When a design engineer, Mr. Scott, looks at a
18 wastewater treatment plant and the firm capacity of the
19 components, does a design engineer take into account
20 peak loading factors such as peak hour demand and peak
21 day demand?

22 A. Yes. There is, they call it, I guess, peaking
23 design factors. It comes in daily, monthly, or hourly.
24 And that's what the design engineer looks at. And in
25 fact it is required by DEQ that they submit that

1 information.

2 Q. So the components of the system have to be
3 designed in a way to handle the peak loading factors,
4 which in many cases is much higher than the rated
5 treatment capacity of the plant, agreed?

6 A. Yes.

7 MR. WILEY: No more questions, Your Honor.

8 ACALJ NODES: Anything further?

9 MS. WOOD: Just one question.

10

11 FURTHER RECROSS-EXAMINATION

12 BY MS. WOOD:

13 Q. Is it true that a plant -- and I am talking
14 about the total plant -- is rate based on the capacity
15 of the lowest element of the -- or lowest, the capacity
16 of the lowest capacity element or components of that
17 plant?

18 For example, if you have a treatment train at
19 5.0 MGD and you have all other aspects of the plant at
20 15 MGD, you are not going to get a rating above the
21 lowest level or the lowest capacity of the lowest
22 capacity component of the plant, correct?

23 A. That's the loaded question for, to be a design
24 engineer, what is required by DEQ or the county. I
25 really can't answer that because of certain sizes that

1 plant facilities or wastewater plant facilities where
2 there is, they call it contact time, certain time
3 through the treatment process. So difficult for me to
4 answer that.

5 Q. Okay. And when you filed your reports with the
6 Commission, had you reviewed -- you said you hadn't
7 reviewed the DEQ documents that Mr. McBride went over
8 during his testimony, correct?

9 A. I did not.

10 Q. Okay. Had you reviewed any of the other DEQ
11 documents?

12 A. No. I mainly reviewed through Maricopa County.

13 Q. Okay. What did you review?

14 A. The approval of constructions.

15 Q. Okay. And other than the approval of
16 constructions, did you review anything else?

17 A. No.

18 ACALJ NODES: Okay. Anything further from
19 anyone? Ms. Mitchell, do you have anything?

20 MS. MITCHELL: No, Your Honor.

21 ACALJ NODES: All right. Mr. Wiley, are you
22 finished?

23 MR. WILEY: Yes.

24 ACALJ NODES: All right. Thank you, Mr. Scott,
25 for your testimony. And you are excused.

1 And I think we will take a 10-minute break here
2 and come back with, I guess it is, Mr. Manrique.

3 MS. MITCHELL: Correct.

4 ACALJ NODES: Okay.

5 (A recess ensued from 10:48 a.m. to 10:59 a.m.)

6 ACALJ NODES: Okay. Let's get started.

7 Ms. Mitchell, do you want to call your next
8 witness?

9 MS. MITCHELL: Certainly. Thank you, Judge
10 Nodes. Staff would call Juan Manrique to the stand.

11

12 JUAN MANRIQUE,

13 called as a witness on behalf of ACC Staff, having been
14 first duly sworn by the Certified Reporter to speak the
15 truth and nothing but the truth, was examined and
16 testified as follows:

17

18 DIRECT EXAMINATION

19 BY MS. MITCHELL:

20 Q. Good morning, Mr. Manrique. Would you please
21 state your name and business address for the record.

22 A. My name is Juan Manrique. I work at the Arizona
23 Corporation Commission at 1200 West Washington in
24 Phoenix, Arizona 85007.

25 Q. And what is your position with the Corporation

1 Commission?

2 A. I am a utilities analyst.

3 Q. And could you describe your duties as a
4 utilities analyst.

5 A. I generally deal with utility financing cases
6 and cost of equity cases as well.

7 Q. And in the course of your employment, were you
8 assigned to review and evaluate the application for a
9 rate increase for LPSCO?

10 A. Yes.

11 Q. And did you prepare and prefile any testimony
12 for this case?

13 A. Yes.

14 Q. You have in front of you what has been marked as
15 Staff Exhibit S-12. Can you please identify that for
16 the record.

17 A. That is my direct testimony in this case.

18 Q. And do you have any additions, corrections, or
19 modifications to make to S-12?

20 A. No.

21 Q. And do you adopt S-12 as part of your sworn
22 testimony?

23 A. I do.

24 Q. You have in front of you what has been marked as
25 Staff Exhibit S-13. Could you please identify that for

1 the record.

2 A. That is my surrebuttal testimony in this case.

3 Q. And do you have any additions, corrections, or
4 modifications to make to S-13 at this time?

5 A. No.

6 Q. And do you adopt S-13 as part of your sworn
7 testimony today?

8 A. I do.

9 MS. MITCHELL: Your Honor, at this time I would
10 like to move for the admission of S-12 and S-13.

11 ACALJ NODES: All right. Any objections?

12 (No response.)

13 ACALJ NODES: S-12 and S-13 are admitted.

14 (Exhibits S-12 and S-13 were admitted into
15 evidence.)

16 MS. MITCHELL: Thank you.

17 BY MS. MITCHELL:

18 Q. Mr. Manrique, do you think the Commission should
19 consider the general economic conditions in the U.S.
20 when establishing a cost of equity?

21 A. Generally speaking, yes. And, you know, my cost
22 of capital analysis does take into account current, you
23 know, current economic conditions in the U.S., and
24 globally, too, you know, to a certain extent. And, you
25 know, should they adopt, you know, my testimony, then

1 they would be taking current economic conditions into
2 account.

3 MS. MITCHELL: All right. Thank you.

4 I have no further questions for this witness.
5 He is available for cross-examination.

6 ACALJ NODES: Mr. Udall, do you have any
7 questions for this witness?

8 MR. UDALL: Yes, I do, Your Honor.

9

10 CROSS-EXAMINATION

11 BY MR. UDALL:

12 Q. Good morning, Mr. Manrique. My name is Larry
13 Udall. I am representing the City of Litchfield Park.

14 ACALJ NODES: Can you just, Mr. Udall, can you
15 pull the microphone just a little closer so you can be
16 heard.

17 MR. UDALL: Sure.

18 ACALJ NODES: Thank you.

19 BY MR. UDALL:

20 Q. Mr. Manrique, you have testified in many rate
21 cases before the Commission, is that correct?

22 A. One other rate case.

23 Q. Okay. Do you agree that the Commission
24 exercises a wide range of discretion in determining what
25 constitutes fair and reasonable rates?

1 MR. SHAPIRO: Are you asking him as a legal
2 matter or are you asking him based on his experience,
3 Mr. Udall?

4 MR. UDALL: Both.

5 MR. SHAPIRO: Then I will object on the basis it
6 calls for a legal conclusion.

7 ACALJ NODES: Yes. You can't ask this witness
8 for a legal opinion. So if you limit it to his opinion
9 based on his experience, the question is fine.

10 MR. UDALL: Very good.

11 BY MR. UDALL:

12 Q. Mr. Manrique, just based on your experience,
13 would you agree that the Commission exercises a wide
14 range of discretion?

15 A. Yes.

16 Q. And do you know of any Commission rules or
17 orders or statutes or court decisions that prohibit the
18 Commission from considering rate shock or economic
19 conditions in setting fair and reasonable rates?

20 A. The only rules or, you know, court decisions
21 that I know of that, you know, that the Commission uses
22 and that really any commission, I guess, is supposed to
23 use are the Supreme Court, you know, decisions
24 governing, you know, what a utility is sort of allowed
25 to make, if you will, or should, you know, should make.

1 Q. Okay. But you are not aware of any court
2 decision, are you, that specifically states that the
3 Commission cannot consider such things as rate shock or
4 economic conditions when it sets fair and reasonable
5 rates?

6 A. I am not aware of any rules against that, no.

7 Q. Or case -- any decisions by an Appellate Court
8 of Arizona?

9 A. I am not aware, no.

10 Q. Would you agree that, and in other words, would
11 you agree that there is no absolute formula that the
12 Commission is obligated or mandated to follow for
13 setting fair and reasonable rates?

14 A. There is no prescribed formula. However, as I
15 mentioned before, there is sort of like a proscribed end
16 result, if you will, where utilities are, according to
17 the Supreme Court, they, you know, in setting rates,
18 they are supposed to give them the ability to, you know,
19 make enough, I guess, in terms of profit, if you will,
20 to keep the utility as an ongoing concern where it can,
21 you know, attract capital to keep the company as a going
22 concern.

23 Q. Mr. Manrique, are you aware or know of any
24 Commission rule, order, court decision, or statute that
25 precludes the Commission from phasing in rates?

1 A. I am not aware, no.

2 MR. UDALL: I have no other questions, Your
3 Honor.

4 ACALJ NODES: Thank you.

5 Ms. Wood.

6 MS. WOOD: I don't have any -- well, just one
7 second.

8 No question, Your Honor.

9 ACALJ NODES: Mr. Shapiro.

10

11

CROSS-EXAMINATION

12 BY MR. SHAPIRO:

13 Q. Good morning, Mr. Manrique.

14 A. Good morning.

15 Q. Mr. Udall was asking you some questions based on
16 your experience before the Commission. You have only
17 testified in one other case before this one, correct?

18 A. Correct.

19 Q. And that case hasn't been decided yet, correct?

20 A. Correct.

21 Q. Mr. Manrique, do you consider yourself an expert
22 in determining the cost of capital for regulated
23 utilities for ratemaking purposes?

24 A. Yes.

25 Q. Are you aware of the Appellate Court of

1 Arizona's decision known as Scates?

2 A. No.

3 Q. You and I kind of went through this process a
4 couple months ago in the Black Mountain case, right?

5 A. Yes.

6 Q. Did you do anything materially different to
7 determine your recommended return on equity in this case
8 than you did in the Black Mountain rate case?

9 A. No.

10 Q. You used the same DCF methodology?

11 A. Yes.

12 Q. The same CAPM methodology?

13 A. Yes.

14 Q. And the same financial risk adjustment
15 methodology known as the Hamada adjustment?

16 A. Correct.

17 Q. How did you decide to use book value instead of
18 market value in the Hamada adjustment?

19 A. Staff believes that it is a reasonable and
20 prudent method, so that was the only determining factor
21 in using that particular methodology.

22 Q. Mr. Manrique, did you determine that yourself or
23 were you told that by Staff?

24 A. That is generally how Staff as a whole, you
25 know, makes that determination.

1 Q. Other than Staff's, what you describe as Staff's
2 practice, do you have any authority to cite that
3 supports the use of book value in the Hamada evaluation?

4 A. No.

5 Q. You agree with me that the CAPM is a market
6 based model, correct?

7 A. Yes.

8 Q. And that the Hamada is an extension of the CAPM
9 methodology?

10 A. Yes.

11 Q. And can you identify for me the different inputs
12 that you need to use to do the CAPM analysis that you
13 did?

14 A. If you look on page 28 of my direct testimony,
15 the different inputs that are required for a CAPM
16 calculation is a risk free rate, a return on the market,
17 a beta, and I think those are the three inputs there.

18 Q. And how did you determine that these are the
19 inputs that need to be used?

20 A. Well, that is the mathematical formula for the
21 CAPM.

22 Q. You would agree with me that LPSCO does not have
23 a beta, correct?

24 A. Since they are not a publicly traded company,
25 they do not have an independent beta, correct.

1 Q. And how did you determine what risk-free rate to
2 use in the CAPM?

3 A. As far as the risk-free rate that we use, if you
4 look on page 29 of my direct testimony, we use the
5 average of the five, seven, and ten-year intermediate
6 term U.S. Treasury securities spot rates for the
7 historical risk premium, and the 30-year U.S. Treasury
8 bond spot rate for the current market risk premium.

9 Q. And did you select those yourself, Mr. Manrique,
10 or were those what you were told is used in Staff's CAPM
11 analysis?

12 A. That is generally -- those are generally the
13 risk premiums that are used by Staff, yes.

14 Q. Did you try different inputs into the CAPM,
15 review the results, and then decide on a final position,
16 or did you just select your factors, run them through,
17 and that was the result?

18 A. Yes, I mean, like our standard methodology is to
19 use these particular, you know, these particular inputs
20 in terms of the market risk premiums for the CAPM. And
21 so whatever result we receive, that's what we use.

22 Q. And is the same thing generally true with
23 respect to your analysis using the DCF, you use the
24 inputs that Staff generally uses?

25 A. Correct.

1 Q. Ran the model with Staff's general inputs and
2 came up with your result?

3 A. Yes.

4 MR. SHAPIRO: Thank you, Mr. Manrique.

5 ACALJ NODES: Redirect?

6 MS. MITCHELL: No, Your Honor.

7 ACALJ NODES: All right. Thank you,
8 Mr. Manrique. You are excused.

9 MS. MITCHELL: Can you give me about five
10 minutes, not five minutes, just a couple minutes to get
11 set up for Mr. Michlik?

12 ACALJ NODES: Sure. Well, let's just take a
13 couple-minute break.

14 MR. SHAPIRO: We can discuss this off the
15 record.

16 (A recess ensued from 11:14 a.m. to 11:20 a.m.)

17 ACALJ NODES: Okay. Ms. Mitchell, do you want
18 to call your next witness?

19 MS. MITCHELL: Thank you, Judge Nodes. Staff
20 would call Jeffrey Michlik to the stand.

21

22

23

24

25

1 JEFFREY M. MICHLIK,
2 called as a witness on behalf of ACC Staff, having been
3 first duly sworn by the Certified Reporter to speak the
4 truth and nothing but the truth, was examined and
5 testified as follows:

6 DIRECT EXAMINATION

7 BY MS. MITCHELL:

8 Q. Good morning, Mr. Michlik. Could you please
9 state your name and business address for the record.

10 A. My name is Jeffrey M. Michlik, last name spelled
11 M-i-c-h-l-i-k, and I work here at the Arizona
12 Corporation Commission. And the address is 1200 West
13 Washington Street, Phoenix, Arizona 85007.

14 Q. And what is your position with the Arizona
15 Corporation Commission?

16 A. I am a Public Utilities Analyst 5.

17 Q. And could you briefly describe your duties as a
18 Public Utilities Analyst 5.

19 A. Mainly I examine rate cases, financing, tariffs,
20 accounting orders, and any other items that the
21 Commission might have me examine.

22 Q. And in the course of your employment, were you
23 assigned to review and evaluate the request for a rate
24 increase by LPSCO?

25 A. Yes.

1 Q. And did you prepare and prefile any testimony
2 for this case?

3 A. Yes.

4 Q. All right. You have in front of you what has
5 been marked as Staff Exhibit S-14?

6 A. Yes.

7 Q. Could you identify that for the record.

8 A. That's my direct testimony in this case.

9 Q. And is that for the water division?

10 A. Yes.

11 Q. And do you have any additions, corrections or
12 modifications to make to S-14 at this time?

13 A. Yes.

14 Q. All right. Let's go through them.

15 A. Okay. On page 10, line 5, what adjustment did
16 Staff make? Answer on line 6, it should state Staff
17 increased instead of decreased.

18 On Schedule JMM-W12, column B, states JMM-W12,
19 it should actually be JMM-W13.

20 Q. Is that down under the references?

21 A. Yes. It is the reference section.

22 Q. Continue.

23 A. And under the --

24 ACALJ NODES: Wait a minute. I didn't get that
25 last change.

1 THE WITNESS: Column B, it says schedule
2 JMM-W12, it should actually be JMM-W13.

3 ACALJ NODES: Oh, you are talking about the
4 footnote.

5 THE WITNESS: On the reference, yes.

6 ACALJ NODES: Okay, thank you.

7 THE WITNESS: And then underneath the reference,
8 column D, should be added also as a reference JMM-W1.
9 Where I have 18 and 19, should also be W1 also.

10 ACALJ NODES: So both of them should be W1?

11 THE WITNESS: No, just column D, just add W1.

12 ACALJ NODES: Oh, add W1 --

13 THE WITNESS: Yes.

14 ACALJ NODES: -- to 18 and --

15 THE WITNESS: And 19, yes.

16 ACALJ NODES: Okay.

17 THE WITNESS: Schedule W19, instead of stating
18 operating income adjustment number 6, it should actually
19 be number -- excuse me, number 12, it should actually be
20 number 6.

21 MR. SHAPIRO: I am sorry, Mr. Michlik, can you
22 give that page again.

23 THE WITNESS: It is Schedule W19.

24 MR. SHAPIRO: Thank you.

25 ACALJ NODES: And what is the change again?

1 THE WITNESS: It says operating income
2 adjustment number 12. It should actually be number 6 at
3 the top.

4 MS. MITCHELL: It is the title at the top.

5 ACALJ NODES: Oh, the title, okay, should be
6 number 6.

7 THE WITNESS: Uh-huh.

8 ACALJ NODES: Okay.

9 THE WITNESS: And then on Schedule JMM-W20,
10 again, the title should not be adjustment number 13, it
11 should be adjustment 7.

12 BY MS. MITCHELL:

13 Q. And with those corrections, do you adopt S-14 as
14 your sworn testimony?

15 A. Yes.

16 Q. Thank you.

17 You have in front of you what has been marked as
18 Staff Exhibit S-15. Could you please identify that for
19 the record.

20 A. This would be my surrebuttal testimony for the
21 water division.

22 Q. And do you have any additions, modifications, or
23 corrections to make to S-15?

24 A. I have some minor typos to correct.

25 Q. Okay. Let's go through those.

1 A. Okay. On page, actually Schedule W13, the
2 reference is column D, I just need to add a reference to
3 JMM-W1.

4 Q. And that's column D?

5 A. Yes.

6 Q. And is that it?

7 A. That's it.

8 Q. And with that correction do you adopt S-15 as
9 your sworn testimony today?

10 A. Yes.

11 Q. All right. I think you have what I have marked
12 as Staff Exhibit S-16. Could you identify that for the
13 record.

14 A. This is my direct testimony for the wastewater
15 division.

16 Q. And do you have any modifications or corrections
17 to make to make to S-16?

18 A. Yes.

19 Q. Oh.

20 A. On Schedule JMM-WW1, again, at the bottom in the
21 reference section, column B should read Schedule
22 JMM-WW12 and eliminate MEM-13. And also in the
23 reference section, column D, eliminate MEM-1, MEM-2, and
24 insert JMM-WW1, JMM-WW19, and JMM-WW20.

25 Q. And with that correction, do you adopt -- where

1 am I? -- S-16 as your sworn testimony today?

2 A. Yes.

3 Q. And you have what has been marked as S-17.

4 Could you identify that for the record.

5 A. Yes. This is my wastewater surrebuttal.

6 Q. And do you have any additions, corrections or
7 modifications to make to S-17?

8 A. Yes.

9 Q. Okay. Let's go through those.

10 A. Again on JMM-WW12, on the reference section,
11 column B should also include JMM-WW1.

12 Q. Is that it?

13 A. Yes.

14 Q. All right. And with that correction do you
15 adopt S-17 as your sworn testimony today?

16 A. I do.

17 MS. MITCHELL: Your Honor, at this time I would
18 like to move for the admission of S-14, S-15, S-16, and
19 S-17.

20 ACALJ NODES: All right. Any objections?

21 (No response.)

22 ACALJ NODES: Okay. S-14 through 17 are
23 admitted.

24 (Exhibits S-14 through S-17 were admitted into
25 evidence.)

1 ACALJ NODES: And I assume, Mr. Michlik, if you
2 were asked the questions contained within these
3 exhibits -- oh, were you going to already do that?

4 MS. MITCHELL: No, you can go ahead. I asked
5 him if he adopts it as his sworn testimony, but if you
6 want to ask a different question, that's okay.

7 ACALJ NODES: Okay, okay. No.

8 You would give the same answers today?

9 THE WITNESS: Yes.

10 ACALJ NODES: Okay. Thank you.

11 Mr. Udall, do you have --

12 MS. MITCHELL: I wasn't finished.

13 ACALJ NODES: Oh, I am sorry. I am trying --

14 MS. MITCHELL: Trying to rush it along. That's
15 okay. I wish I were finished, but I do have just a
16 couple of questions for Mr. Michlik on direct.

17 ACALJ NODES: Sorry about that.

18 MS. MITCHELL: Oh, that's okay.

19 BY MS. MITCHELL:

20 Q. Were you listening this morning during the
21 testimony of Mr. Scott when he was questioned by
22 Mr. Wiley and Judge Nodes concerning the financing
23 application?

24 A. Yeah, I was, some parts, yes.

25 Q. Well, I will summarize it for you. I believe

1 Mr. Wiley asked Mr. Scott a question that if the company
2 were to essentially use the debt for a similar, a
3 similar project, just a different technology in the
4 recharge, would that change the Staff recommendation.
5 And I believe Mr. Scott said that he, Staff would need
6 some more information.

7 I just wanted to confirm with you that you would
8 probably need to evaluate the application should they
9 make any changes in the technology, just to make sure
10 that they were still using the debt in the same way, you
11 would need additional information.

12 A. Right. And actually we did get a memo from
13 Mr. Scott indicating whether the financing should be
14 approved, if the financing for the equipment is needed
15 and it is reasonable.

16 Q. And I believe in your testimony on the financing
17 application you indicated that you had not seen any
18 notice given of the financing application. It is in
19 your direct testimony.

20 A. I believe so then.

21 Q. And to date you have not seen the company doing
22 any filing with respect to any kind of notice regarding
23 their financing application, is that correct?

24 A. I haven't seen any.

25 Q. Okay. I want to talk a little bit just to

1 clarify the Staff position on rate case expense.

2 ACALJ NODES: Can I ask a question --

3 MS. MITCHELL: Sure.

4 ACALJ NODES: -- on the prior, just so we -- so
5 I am clear on Staff's position?

6 If the order on financing were to state that,
7 something to the effect that the project as built is the
8 same or substantially the same as was indicated in the
9 financing request as far as the actual construction and
10 components, subject to a final review by Staff, would
11 that be language that you would find acceptable in case
12 the company needed to undertake some modifications to
13 the construction of the project?

14 THE WITNESS: I don't think we have a problem
15 with it.

16 ACALJ NODES: Okay. All right. I am sorry. Go
17 ahead, Ms. Mitchell.

18 MS. MITCHELL: Oh, never a problem when you
19 interrupt.

20 BY MS. MITCHELL:

21 Q. Mr. Michlik, what does Staff recommend for a
22 normalization of rate case expense?

23 A. Usually Staff recommends between three to five
24 years, in that range.

25 Q. And for this case, how did Staff arrive at the

1 five-year normalization period?

2 A. The company hadn't been in for nine years, so we
3 actually used the top end of the range of five years.

4 Q. I want to talk a little bit about the issue of
5 customer deposits and security deposits. Does Staff
6 include customer deposits in rate base?

7 A. Yes.

8 Q. All right. I have an exhibit that I want to
9 show you. I believe it is already up there. It is
10 S-18. But I want to pass out copies to the parties.

11 (Brief pause.)

12 BY MS. MITCHELL:

13 Q. Mr. Michlik, I have given you a document that I
14 have marked as Staff Exhibit S-18. Could you identify
15 that for the record.

16 A. Yes. It is -- the title page is the Accounting
17 for Public Utilities, and the specific reference relates
18 to customer deposits.

19 Q. And did you review this publication in making
20 your recommendation concerning customer deposits?

21 A. Yes.

22 Q. Does this publication, does it distinguish
23 between customer deposits for meters and customer
24 deposits for security?

25 A. No, it does not.

1 Q. All right. Does NARUC differentiate between
2 customer meter deposits and customer security deposits?

3 A. No, it does not.

4 Q. I have another document for you. Just one
5 moment.

6 (Brief pause.)

7 BY MS. MITCHELL:

8 Q. You have a document that has been marked as
9 Staff Exhibit S-19. Could you identify that for the
10 record.

11 A. Yes. This is the Uniform System of Accounts for
12 Class A Water Utilities, 1996 edition. And the specific
13 excerpt is balance sheet accounts, item customer
14 deposits at the top of the page.

15 Q. And again, the second page of this document
16 discusses the treatment of customer deposits?

17 A. Yes, at the top of the page.

18 Q. So if we were to include customer deposits in
19 rate base, would the company earn a return on money that
20 wasn't their money?

21 A. If we didn't include it, they would be earning a
22 return. If we include it, then they are not getting a
23 return on the customer, on the customer's money.

24 MS. MITCHELL: Before I forget, Your Honor, I
25 would like to move for the admission of S-18 and S-19.

1 ACALJ NODES: Any objections?

2 MR. SHAPIRO: Yes, Your Honor, there is an
3 objection. Neither of these documents were included in
4 Mr. Michlik's work papers. There is no indication
5 anywhere in his testimony that he relied on them. So it
6 is really just unfair disclosure.

7 ACALJ NODES: Well, isn't it similar to the
8 argument you are making as far as your rebuttal case,
9 and don't we typically and traditionally allow witnesses
10 to, as they are called to the stand, to respond to prior
11 testimony that has occurred during the hearing?

12 MR. SHAPIRO: I guess I am not sure what
13 testimony Mr. Michlik is responding to at this point in
14 time that happened during the hearing. But I know when
15 the company asked for work papers, if he is relying on
16 something in making his adjustment, his materials should
17 be in the work papers. We will withdraw the objection
18 for now and allow this in. I may need a few minutes at
19 a break to discuss with Mr. Bourassa.

20 ACALJ NODES: Okay. Well, I have a question
21 regarding S-18, Mr. Michlik.

22

23 EXAMINATION

24 BY ACALJ NODES:

25 Q. As I understand it from this publication, the

1 way the customer deposits, security deposits or
2 otherwise, are to be treated is if you treat them --
3 if you deduct the amounts from rate base, then, and
4 there is an interest component, then you need to
5 recognize that interest component as a cost of service,
6 correct?

7 A. Correct. That's what it states here.

8 Q. And is that what Staff did in this case?

9 A. Staff didn't present a cost of service. I
10 believe we relied on the company, some modifications.

11 Q. If you didn't present a cost of service study,
12 but if you deduct it from rate base, don't you have to
13 recognize in expenses the cost of -- the interest cost
14 associated with the customer deposits as the other side
15 of the equation?

16 A. Yeah. I don't think we have a problem with
17 that. So if the company wants us to present what the
18 expense is, we can certainly put that into operating
19 expense. However, I note that the interest expense
20 shouldn't be more than the amount of the deposits.

21 Q. Well, the interest rate could not be more than
22 the amount --

23 A. I mean the money they paid in interest expense,
24 yes.

25 Q. Right. Right. Well, that wouldn't be really

1 that -- how would that be possible, even if you had a
2 10 percent interest rate? It wouldn't be possible for
3 that to be more than the amount of the deposit, would
4 it?

5 A. I would agree with you, but I guess I have seen
6 stranger things, so...

7 Q. Oh, okay. Okay. And then alternatively, if
8 you -- the other way to treat it is you just don't treat
9 or you consider it within the capital structure, as I
10 understand it from this publication, for purposes of the
11 rate of return, and in that instance you don't deduct it
12 from rate base.

13 A. Right. You can put it in the weighted average
14 cost of capital and your debt -- your equity, and you
15 can put that in there, customer deposits.

16 Q. So it is your testimony that because Staff
17 proposes to deduct the amount of deposits, both meter
18 deposits and security deposits, from rate base, that you
19 believe it is reasonable for the company to be able to
20 include the interest rate -- interest expense associated
21 with all deposits as a component of operating expenses?

22 A. Yes. For those, for those customer deposits
23 that actually have interest assigned to them on the
24 company's tariff.

25 Q. Right. But at this point, Staff has not given

1 any recognition to the interest component?

2 A. You are correct.

3 Q. And you are just saying that if the company
4 presents that information, Staff would be agreeable to
5 including that within the revenue requirement?

6 A. Yes.

7 ACALJ NODES: Okay. Thank you. And I think I
8 admitted S-18 and 19, I believe. And do you have
9 further questions?

10 (Exhibits S-18 and S-19 were admitted into
11 evidence.)

12 MS. MITCHELL: I do. I do. You keep making me
13 feel guilty like I should just be rushing.

14 ACALJ NODES: Sorry.

15

16 DIRECT EXAMINATION CONTINUED

17 BY MS. MITCHELL:

18 Q. I just wanted to talk a little bit about
19 accumulated deferred income tax or ADIT. On page 10 of
20 Mr. Bourassa's rejoinder I think he stated that Staff
21 was still reviewing the issue of ADIT. And Staff is now
22 recommending an ADIT of 335,487 for the water and a
23 similar amount for the wastewater division, is that
24 correct?

25 A. Yes.

1 MR. SHAPIRO: Ms. Mitchell, can you give us
2 those numbers again.

3 MS. MITCHELL: \$335,487 for the water and the
4 same amount for the wastewater.

5 BY MS. MITCHELL:

6 Q. Now, did the company change its number in its
7 rejoinder?

8 A. They have changed it several times. They have
9 changed the number, I believe, three times.

10 Q. Can you look for me through the exhibits, it is
11 RUCO's Exhibit 7. I believe it is the annual report.

12 A. Yes, I have it here.

13 Q. And within that document is there a number
14 listed for accumulated deferred income tax?

15 A. Yes. It is on page 7.

16 Q. And is that the same number that Staff is
17 recommending?

18 A. Yes, it is.

19 Q. If I showed you the report for the water
20 division -- let me show you that. I believe I have the
21 water division up there and I have marked it as an
22 exhibit. I got copies for the parties. Just a minute.

23 (Brief pause.)

24 MS. WOOD: I apologize for interrupting. With
25 regard to the exhibit you just mentioned, what line is

1 that on?

2 THE WITNESS: There is an account, it says 281
3 on the left-hand side.

4 BY MS. MITCHELL:

5 Q. You had Exhibit S-20?

6 A. Yes.

7 Q. And could you identify that for the record?

8 A. This is an annual report that water and
9 wastewater companies submit to the Arizona Corporation
10 Utilities Division on an annual basis.

11 Q. And could you turn to page 7 of that report.

12 A. Sure.

13 Q. And does it list an amount for accumulated
14 deferred income tax?

15 A. Right. It is account 281, accumulated deferred
16 income tax, and it is the same amount. What they did
17 was took the overall number, then divided it in half.
18 So it is \$335,487.

19 MS. MITCHELL: And before I forget, I would like
20 to move for the admission of S-20.

21 ACALJ NODES: Any objection?

22 MR. SHAPIRO: If you are simply admitting it for
23 the purpose of establishing that number, that's fine.
24 If Staff is attempting to admit it to determine that's
25 the right number, we would have an objection and would

1 need to question Mr. Michlik.

2 ACALJ NODES: Well, I assume you are going to
3 have to question him anyway.

4 MR. SHAPIRO: That's true.

5 ACALJ NODES: So --

6 MR. SHAPIRO: That's true, Judge.

7 ACALJ NODES: -- I will admit Staff
8 Exhibit S-20.

9 (Exhibit S-20 was admitted into evidence.)

10 BY MS. MITCHELL:

11 Q. I want to talk a little bit about the Staff
12 adjustment relating to the TCE plume. Is Staff
13 recommending a disallowance of the cost associated with
14 the whole investigation of that TCE plume?

15 A. Staff is not recommending an allowance or
16 disallowance at this time. We are just stating that it
17 is probably not ripe for adjudication in this rate
18 proceeding, and we would look at it in a future rate
19 proceeding.

20 Q. So there is nothing to preclude the company from
21 coming back to seek recovery in a later rate case?

22 A. No.

23 Q. And my last topic, I would like to discuss the
24 cost allocation which is at issue in this case. Can you
25 explain how Staff arrived at the 10 percent cost

1 allowance?

2 A. Sure. First we analyzed the cost pools. First
3 of all we think all of these costs related to the
4 corporate level are -- should be directly costs to the
5 shareholders, because they are the primary beneficiaries
6 of these costs.

7 However, Staff does acknowledge that there could
8 be some residual or secondary benefit to the ratepayers
9 in the LPSCO water system, the wastewater system. So we
10 thought instead of disallowing it all, we would just set
11 that amount at 10 percent. We think it is pretty
12 generous.

13 Q. All right. And then I have one other question
14 on something in Mr. Bourassa's rejoinder. It is on -- I
15 can't remember the exhibit number. You might want to
16 refer to it. It is on page 22. And he discusses that
17 he thinks that there is an error in the computation of
18 depreciation expense made by Staff.

19 A. And that's related to the post test year plant.

20 Q. I guess. I suppose.

21 A. I think that was related to the post test year
22 plant, so we are putting it in service. Then I would
23 agree that depreciation expense should be calculated on
24 post test year plant.

25 Q. So basically Staff is going to make an

1 adjustment to its computation in the final schedules?

2 A. Yes.

3 ACALJ NODES: Okay. Just so I am clear, you are
4 talking about Mr. Bourassa's rebuttal testimony at
5 page 22?

6 MS. MITCHELL: I think rejoinder.

7 ACALJ NODES: Rejoinder.

8 MS. MITCHELL: It is rejoinder at 22.

9 ACALJ NODES: And again, what is your agreement
10 now with Mr. Bourassa?

11 THE WITNESS: I believe Mr. Bourassa stated
12 there is some post test year plant that Staff did not
13 calculate depreciation expense on.

14 ACALJ NODES: Okay. And so you are now agreeing
15 with Mr. Bourassa's testimony on that issue?

16 THE WITNESS: Yes.

17 ACALJ NODES: Okay. And that would be
18 depreciation expense of \$62,796?

19 THE WITNESS: I have to recalculate, make sure
20 the numbers are correct, but at this point I have no
21 reason to fault those numbers.

22 ACALJ NODES: So, well, you would agree with the
23 depreciation rate of 3.33 percent applied to the
24 \$1,885,770?

25 THE WITNESS: I would have to check with our

1 engineer on that, make sure we are using the right
2 depreciation rate.

3 ACALJ NODES: Okay.

4 THE WITNESS: But overall, I guess I am stating
5 that that piece of post test year plant should be
6 depreciated.

7 ACALJ NODES: Assuming the engineer agrees with
8 the rate and the amount of the plant, Staff is in
9 agreement in theory with Mr. Bourassa's testimony on
10 that point?

11 THE WITNESS: Correct.

12 ACALJ NODES: Okay.

13 MS. MITCHELL: I don't have anything else for
14 Mr. Michlik on direct. It may be a good time to break
15 for lunch.

16 ACALJ NODES: It might be.

17 Mr. Udall, are you going to have questions for
18 this witness?

19 MR. UDALL: No.

20 ACALJ NODES: No, okay. And Ms. Wood, how much,
21 just as a ballpark?

22 MS. WOOD: I have four questions.

23 ACALJ NODES: Why don't we go ahead and do that
24 and we can come back fresh with the company.

25 For the record, Mr. Udall, you don't have any

1 questions for this witness?

2 MR. UDALL: That's correct.

3 ACALJ NODES: Okay. And Ms. Wood.

4 MS. WOOD: Yes.

5

6 CROSS-EXAMINATION

7 BY MS. WOOD:

8 Q. Good morning, Mr. Michlik.

9 A. Good morning.

10 Q. Staff used or prefers or normally uses a
11 four-factor method for allocating common costs, correct?

12 A. Correct.

13 Q. Okay. And these four factors are plant,
14 customers, expenses, and labor?

15 A. I don't have the prior decisions in front of me,
16 but I believe we do use some of those determinants.

17 Q. If those four factors are not known, would
18 allocating based on the revenue be appropriate?

19 A. Well, there would be different ways you could
20 possibly allocate it. You can just allocate it by all
21 the companies if some of those cost drivers aren't
22 known.

23 MS. WOOD: Okay. Thank you.

24 ACALJ NODES: Okay. All right. We will break
25 for lunch until 1:00.

1 (A recess ensued from 11:54 a.m. to 1:04 p.m.)

2 ACALJ NODES: Let's go back on the record.

3 We are ready to begin the cross by the company's
4 counsel. Who is going first? Mr. Wiley?

5 MR. WILEY: Yes, Your Honor. Thank you.

6

7 CROSS-EXAMINATION

8 BY MR. WILEY:

9 Q. Mr. Michlik, good afternoon.

10 A. Good afternoon.

11 Q. We are going to start on the affiliate cost
12 allocation topic to start with. One thing I wanted to
13 clarify before I start on my line of questions is
14 Ms. Wood asked you a question about the use of a revenue
15 based allocation model and the four-factor allocation
16 model. Do you recall that question?

17 A. Yes.

18 Q. The four-factor allocation is only used with the
19 Liberty Water costs that are allocated from Algonquin
20 Water Services dba Liberty Water to LPSCO, correct?

21 A. Yes.

22 Q. And you don't have any objections or deductions
23 for the allocation from Liberty Water to LPSCO, agreed?

24 A. Yes, it is only the corporate level where we
25 have disagreement.

1 Q. Right. And the revenue calculation would be
2 used with the allocation of the APT costs, correct?

3 A. Correct.

4 Q. And so when Ms. Wood asked you about using
5 revenue in place of the four-factor methodology, and I
6 think you said yes, that's actually mixing up two
7 different methodologies, correct?

8 A. Correct.

9 Q. Okay.

10 MR. SHAPIRO: Judge, I am sorry, we wanted to
11 discuss whether we should bring Mr. Jones down this
12 afternoon. We are certainly happy to bring him in and
13 do his direct and bring him back in the morning for his
14 cross-examination if that would aid RUCO in the
15 preparation. So we could call him now and have him head
16 down here for this afternoon, if that would be better.

17 ACALJ NODES: We still have Mr. Chaves to go,
18 correct?

19 MS. MITCHELL: That's correct.

20 ACALJ NODES: And is the company going to have
21 cross for Mr. Chaves?

22 MR. SHAPIRO: Yes, although not much.

23 ACALJ NODES: And what about RUCO on Mr. Chaves,
24 do you have much?

25 MS. WOOD: No, Your Honor, we have none.

1 ACALJ NODES: All right. So Mr. Udall.

2 MR. UDALL: Maybe one question for Mr. Chaves.

3 ACALJ NODES: So he is not going to be -- well,
4 the question I guess is how long is Mr. Michlik going to
5 be on.

6 MR. SHAPIRO: We are going to move as quick as
7 we can in the hopes we can get Mr. Jones' direct on
8 today at least.

9 ACALJ NODES: All right. Then, well, go ahead
10 and call him, tell him to come in.

11 BY MR. WILEY:

12 Q. Mr. Michlik, in your testimony you recommend
13 decreasing the operating expenses for water and sewer
14 essentially by decreasing 90 percent of the affiliate
15 cost allocated from APT, correct?

16 A. No. It is actually we analyzed the cost pools,
17 looked at which cost pools had some, some benefit,
18 peripheral benefit, residual benefit to LPSCO
19 ratepayers. And we allocated 10 percent of those pools.

20 Then we took the total number of companies that
21 LPSCO has, which was 71, and divided whatever the
22 10 percent of those cost pools for the one selected by
23 71, by 71 companies. The company states that it owns or
24 owns an interest in, owns on its financial statements.

25 Q. Do you have your direct testimony there?

1 A. Yes.

2 Q. And just for the record purposes, Mr. Michlik,
3 the analysis you applied for the water division is the
4 same as the analysis you applied for the wastewater
5 division on allocation of APT's costs, agreed?

6 A. Yes.

7 Q. So, in other words, I don't have to go through
8 each of the testimonies separately. If I walked through
9 the water testimony with you, all of the testimonies
10 essentially would apply to the wastewater division
11 except for the specific numbers, agreed?

12 A. Yes.

13 Q. Okay. On page 6 of your direct testimony, lines
14 1 through 3, you have got a line there that says this
15 adjustment decreases operating expenses \$250,182 to
16 remove costs incurred related to the unregulated
17 affiliate's business operations. Do you see that line?

18 A. Is this direct testimony?

19 Q. Direct testimony on water.

20 A. For water? Okay.

21 Q. Do you see that line?

22 A. Uh-huh.

23 Q. You are not opposed to an allocation from an
24 unregulated affiliate of LPSCO, are you, as a general
25 principle?

1 A. No, but again, we were in disagreement with the
2 methodology used by the company.

3 Q. And the methodology that you employed is you
4 took the total central office cost pool, and essentially
5 attributed 90 percent to the income fund and the
6 remaining 10 percent to the facilities owned by the
7 income fund, correct?

8 A. Not quite correct. There is some in the cost
9 pools we, we said there was no allocation, like the
10 trustee fees, unit holder communications, the proxy
11 statements that are sent out to the shareholders. Those
12 are clearly costs that are related to the shareholders.
13 And we did not recommend 10 percent of those allowable
14 costs should be allocated down to the 71 companies that
15 LPSCO owns.

16 Q. And then once you eventually arrived at your own
17 cost pool, you then essentially allocated 1.4 percent to
18 LPSCO based upon a number of one out of 71 facilities,
19 agreed?

20 A. Agreed.

21 Q. Let me turn you to page 16 of your direct
22 testimony. Okay. Now, the gist of your direct
23 testimony here is that on line 6 to 7, you have got a
24 line there that says the primary goal of a cost
25 allocation is, quote, the fair distribution of costs

1 between the unregulated and regulated affiliates through
2 proper allocations. Do you see that line?

3 A. Yes.

4 Q. Okay. And the fair distribution essentially is
5 guided with the principle that you don't want captive
6 ratepayers subsidizing the business operations of an
7 unregulated entity, agreed?

8 A. Agreed.

9 Q. The reverse of that would also apply, wouldn't
10 it? In other words, it wouldn't be fair if unregulated
11 business entities were subsidizing the business
12 operations of regulated entities, agreed?

13 A. I think if some of the cost benefits the, or
14 could secondarily benefit the ratepayers, we have made
15 that allowance for them.

16 Q. I am not sure that answered my question,
17 Mr. Michlik.

18 A. Okay.

19 Q. Okay. My question --

20 A. Can you repeat your question.

21 Q. In order to be fair, it would also be
22 appropriate that unregulated -- that the businesses of
23 unregulated entities do not subsidize services provided
24 to regulated entities. You would agree with that,
25 correct?

1 A. Generally, yes.

2 Q. And so what I am saying is as a general
3 principle, the premise of your testimony is that you
4 don't want captive ratepayers subsidizing the business
5 operations of unregulated entities, agreed?

6 A. Yes.

7 Q. And so the reverse of that would also be true,
8 that you don't want unregulated businesses subsidizing
9 the business operations of regulated entities, agreed?

10 ACALJ NODES: I think you just mixed that up.

11 MR. WILEY: Did I reverse the question?

12 ACALJ NODES: Yes, I think you did.

13 MR. WILEY: Let me retry to state that.

14 BY MR. WILEY:

15 Q. Mr. Michlik, the premise of your testimony is
16 that you don't want captive ratepayers of LPSCO
17 subsidizing the business operations of the unregulated
18 entities or other regulated entities of the income fund,
19 agreed?

20 A. Agreed.

21 Q. Okay. So the reverse of that would also be
22 true, that you wouldn't want the businesses of the
23 unregulated entities owned by the income fund or the
24 other regulated entities of the income fund wouldn't
25 want to subsidize the business operations of LPSCO,

1 agreed?

2 A. Yes, generally, yes.

3 Q. And you would also recognize that there are
4 common costs incurred by certain services that will
5 benefit both regulated entities and unregulated
6 entities, agreed?

7 A. But that's not the primary purpose for the
8 costs. The primary purpose of the costs were generated
9 for the shareholders, but yes, it is true there might be
10 secondary or residual benefits that trickle down to some
11 of the affiliates.

12 Q. And in fact, have you reviewed the NARUC
13 guidelines on affiliate cost allocations?

14 A. Yes.

15 Q. Okay. There is a definition of common costs in
16 those NARUC guidelines which recognizes the fact that
17 there are costs and services that would mutually benefit
18 regulated entities and nonregulated entities, agreed?

19 A. Yes.

20 Q. Okay.

21 ACALJ NODES: Mr. Michlik, are you aware of
22 prior decisions by the Commission where the Commission
23 has disallowed claimed expenses, either entirely or in
24 part, based on the Commission's assessment of whether
25 the incurrence of those costs benefit shareholders

1 versus ratepayers either entirely or in part, and/or
2 whether such expenses were necessary for the provision
3 of service to customers?

4 THE WITNESS: Yes, but I can't recall the case
5 off the top of my head, though.

6 ACALJ NODES: But there have been several cases
7 over the past several years where the Commission has
8 made a judgment as to whether certain expenses, such as
9 retirement benefits for executives and stock options and
10 things of that sort, were really necessary for the
11 provision of service, utility service, to customers, is
12 that what -- are those the kinds of things --

13 THE WITNESS: Yes.

14 ACALJ NODES: -- recognized?

15 THE WITNESS: Uh-huh.

16 ACALJ NODES: Okay. So the Commission has in
17 the past undertaken that kind of an analysis, Staff has
18 as well, correct?

19 THE WITNESS: Correct.

20 ACALJ NODES: Okay. Thank you.

21 BY MR. WILEY:

22 Q. Mr. Michlik, if we look back at page 16 of your
23 direct testimony on water, on lines 15 and 16 you have
24 got a line that states, quote, the cost of a regulated
25 utility such as LPSCO should only include those costs

1 that would have been incurred on a stand-alone basis.

2 Do you see that line?

3 A. Yes.

4 Q. Okay. So that's the standard that you are
5 essentially applying in evaluating the services
6 allocated down from APT, agreed?

7 A. Agreed.

8 Q. Okay. Is that standard -- the stand-alone
9 standard that Staff is applying is not written or
10 documented in any written rules, regulations, or
11 policies of the Commission, agreed?

12 A. I am not sure.

13 Q. To your knowledge is that stand-alone standard
14 documented or written in any published rules,
15 regulations, or policies of the Commission Staff?

16 A. I know it is, it has been referred to in other
17 cases.

18 Q. I don't think that's answering my question.
19 Mr. Michlik.

20 A. Well, you asked me if I was aware of where it
21 was written. Yeah, it has been written in previous
22 Staff reports. In fact, this methodology follows the
23 same course as the recent Black Mountain case.

24 Q. Okay. But let's set decisions aside. Okay?
25 Has that stand-alone affiliate cost standard that you

1 have applied in this case been set forth in any written
2 policies, rules, and regulations of the Commission
3 Staff?

4 A. Not that I am aware of.

5 Q. Okay. And so what you just referred to is that
6 standard has been applied in certain other cases that
7 the Commission has considered relating to affiliate
8 costs?

9 A. And also maybe in Commission orders.

10 Q. Okay.

11 A. Commission amendments.

12 Q. Tell me what commission order you are aware of
13 as we sit here today.

14 A. I am not going to be able to pull this off the
15 top of my head.

16 Q. Okay. And you reference the recent Black
17 Mountain decision. Do you know when that decision was
18 issued?

19 A. It is pending.

20 Q. Okay. So you are talking about the pending
21 Black Mountain Sewer Company rate case, agreed?

22 A. Agreed.

23 Q. Okay.

24 A. Same, similar methodology also being used by
25 Staff in the Rio Rico case.

1 Q. Which is also currently pending, agreed?

2 A. Agreed.

3 Q. Okay. So in the start of the test year in
4 2007 -- so at the start of the test year in September of
5 2007, are you aware of any written decisions, rules,
6 regulations, or policies from the Commission or
7 Commission Staff setting forth the stand-alone
8 comparison as the proper way to allocate affiliated
9 costs?

10 A. I am not aware, but there could be one out
11 there.

12 Q. How did you come up with that standard for
13 using -- how did you come to use that standard in your
14 testimony in this case?

15 A. It is the same, basically the same standard that
16 was in the Black Mountain.

17 Q. Did you do any independent analysis of your own
18 to evaluate whether that's the proper standard or not?

19 A. Yes. I sat down with the other analysts. I
20 also sat down with my manager. I also sat down with the
21 accounting chief. And we decided the same method was
22 appropriate in this case, and also be appropriate in Rio
23 Rico's and any other cases that Algonquin has coming
24 down, or APIF, Algonquin has coming down the pipeline.

25 Q. Has the Commission Staff applied that standard

1 to the Global Utilities and Global's currently pending
2 rate case?

3 A. I am not sure. I wasn't the analyst assigned to
4 that case.

5 Q. It would be inconsistent if the Commission Staff
6 applied a different standard for Global's affiliate
7 costs compared to APIF's affiliate costs, agreed?

8 A. They are not exactly the same cases. They are
9 not exactly the same cost pools. If you want to make
10 it, make a case that's similar, then you should have
11 made that case, what costs both you thought were the
12 same, what cost pools you didn't think the same.

13 I have read Mr. Tremblay's testimony cited a
14 similarity, but I really haven't expounded on what costs
15 are similar and what weren't.

16 Q. Well, I am not sure that answered my question,
17 Mr. Michlik. What I was asking you is, in general
18 terms, the Commission Staff is going to want to apply
19 the same affiliate cost standard for evaluating
20 affiliate cost allocation for Global and LPSCO and
21 LPSCO's parent, APIF, agreed?

22 A. Apply the same standards and, yes, just the APIF
23 and LPSCO.

24 Q. So when Commission Staff is looking at the
25 affiliate cost allocated down from Global's parent, the

1 Commission Staff wants to be consistent in evaluating
2 whether those costs will be incurred on a stand-alone
3 basis by the utility in evaluating the appropriateness
4 of certain costs, agreed?

5 A. No, because they are based on perhaps different
6 allocation methods and different cost pools, so we may
7 not be able to use the same methodology that we do in
8 one particular case against another particular case.

9 ACALJ NODES: Mr. Michlik, let me see if I can
10 explore a hypothetical example. Let's say you have a
11 utility company with 100 customers. Okay? And would
12 your general opinion be that it is unlikely it would be
13 reasonable for a corporate cost allocation for that size
14 company of the type of APIF type expenses, corporate
15 expenses, and I am speaking hypothetically, if you were
16 to undertake an analysis of a utility company, water or
17 sewer company that had 100 customers, would you expect
18 to see corporate allocations flow down in a manner
19 similar to what has been proposed the APIF corporate
20 costs?

21 THE WITNESS: When I analyzed, when I have
22 analyzed my recent costs, I haven't seen all these costs
23 flowing through, no.

24 ACALJ NODES: Okay. So let me ask it this way.
25 When you are undertaking an analysis of whether cost

1 allocations are reasonable from a corporate level, do
2 you take into consideration the size of the company,
3 whether you believe that the type of allocated expenses
4 are the type that are, in your mind, reasonably
5 necessary for the provision of service for a company of
6 similar size that would not have a corporate parent
7 structure that allocates down?

8 THE WITNESS: Right. If we look at these cost
9 pools and we can see, okay, this definitely does benefit
10 ratepayers, then we most likely could pass it through.
11 But in this case we have to look who is it benefiting,
12 is it benefiting the ratepayers or primarily for the
13 shareholder.

14 ACALJ NODES: Okay. And so when you are using
15 the so-called stand-alone criteria, what you are really
16 looking at, if I understand it, is whether you believe,
17 whether Staff believes that the costs that are -- that
18 the company is seeking to be included in the revenue
19 requirement as expenses, that you believe for that
20 company are reasonably necessary for the provision of
21 adequate service to be provided to that company's
22 customers, correct?

23 THE WITNESS: Yes. And it should be comparable
24 to other stand-alone water and wastewater companies in
25 the State of Arizona.

1 ACALJ NODES: So if historically the Commission
2 has experience with companies of similar size and they
3 have been shown to be providing reasonable and adequate
4 service without the types of corporate allocations as
5 have been proposed in this case, that's the kind of
6 comparative analysis that Staff would undertake or
7 consider in making its recommendation?

8 THE WITNESS: Yes.

9 ACALJ NODES: Okay. All right.
10 Go ahead, Mr. Wiley.

11 MR. WILEY: Thank you, Judge.

12 BY MR. WILEY:

13 Q. Mr. Michlik, you are assuming the stand-alone
14 companies and companies with the shared services model
15 are providing the same level of service, are you?

16 A. They should both provide the level of service
17 that is necessary for the provision of the water
18 service.

19 Q. You would agree that companies with the shared
20 services model can provide services that aren't
21 available to stand-alone utilities, agreed?

22 A. Yeah, but the question is are these services
23 needed for the provision of water companies.

24 Q. But you would agree with the general notion that
25 a shared services model provides utilities with access

1 to services that may not generally be available to
2 stand-alone utilities because of costs, fair?

3 A. I agree with that.

4 Q. And that's a recognition of the economies of
5 scale concept, agreed?

6 A. Agreed.

7 Q. Now, it is not Staff's position that LPSCO
8 should be operating as a stand-alone utility, is it?

9 A. No, but we have to make that comparison.

10 Q. Okay. What utilities, what stand-alone
11 utilities did you compare to LPSCO in terms of whether
12 the cost allocated from APT would have been incurred by
13 the same -- by the stand-alone company?

14 A. We didn't do that analysis. Again, it is not
15 the burden is on Staff. It is the burden on the company
16 to show that they could present several Arizona water
17 and wastewater companies on the stand-alone basis and
18 then did a comparison of our own that Staff could have
19 analyzed.

20 Q. So in other words, Mr. Michlik, it is LPSCO's
21 burden to comply with a stand-alone comparison standard
22 that was not documented or provided to the company at
23 the start of the test year, agreed?

24 A. Can you restate your question again.

25 Q. Sure. What you are saying is that it is LPSCO's

1 burden to demonstrate that the costs allocated down from
2 APT are comparable to stand-alone utilities. That's
3 what you said, correct?

4 A. Yes.

5 Q. But that stand-alone comparison wasn't made
6 known to LPSCO at the start of the test year, agreed?

7 A. I don't -- that's, that, I guess that's your
8 opinion. The company may, may not have foreseen this.
9 I don't know. I can't speculate on that.

10 Q. I guess what I am asking you, Mr. Michlik, is:
11 How can LPSCO comply with a standard that Staff
12 developed after the filing of the rate case?

13 A. Well, this standard was actually done in the
14 Black Mountain case, and the company should have been
15 able to anticipate the Staff would have used the same
16 methodology and could have provided Staff with some
17 comparisons with Arizona stand-alone water and
18 wastewater companies of similar size.

19 Q. Have you ever developed a cost allocation model
20 for a utility?

21 A. No.

22 Q. This is the first case that you have testified
23 on cost allocations from affiliate companies, agreed?

24 A. Agreed.

25 Q. Okay. Have you ever owned a business?

1 A. No.

2 Q. Have you ever run a business?

3 A. No.

4 Q. Ever hired people, fired people, anything like
5 that in a corporation in the course of operating a
6 business?

7 A. No.

8 Q. Mr. Michlik, what stand-alone utilities in
9 Arizona are of comparable size to LPSCO, to your
10 knowledge?

11 A. You could probably look at maybe Arizona Water,
12 Arizona-American, I would say, you know, similar
13 customers, similar, you know, an Algonquin sized
14 company.

15 Q. Arizona-American has an affiliate holding
16 company structure, agreed?

17 A. Agreed.

18 Q. Okay. So they are not stand-alone, correct?

19 A. Agreed.

20 Q. Okay. Arizona Water Company, I believe, has
21 about 60,000 customers. Is that your understanding as
22 well?

23 A. I am not sure.

24 Q. Okay. To your knowledge, Mr. Michlik, are there
25 any stand-alone companies in Arizona that are of

1 comparable size to LPSCO?

2 A. I am sure there are.

3 Q. How about Far West Utility Company, Far West
4 Sewer and Water Company, which has approximately 22,000
5 customers, that would be of comparable size, agreed?

6 A. I guess so.

7 Q. Okay. Did you look at Far West Utility Company
8 in determining whether the services provided by Far West
9 Sewer and Water Company under a stand-alone structure
10 are adequate utility services?

11 A. No. But I don't believe the company did either.

12 Q. You don't believe that LPSCO did, is that what
13 you were saying? Yes?

14 Remember you have to verbally answer the
15 questions because the court reporter can't take down the
16 nods. That's your position? Can you say yes?

17 MS. MITCHELL: Say yes.

18 THE WITNESS: Yes.

19 BY MR. WILEY:

20 Q. Mr. Michlik, you were present for the earlier
21 portions of this hearing when I asked one of the other
22 witnesses about the Far West Sewer Company case,
23 correct?

24 A. Correct.

25 Q. Okay. And you are aware that Far West recently

1 went in for an interim rate case or recently filed an
2 interim rate, an interim rate application, agreed?

3 A. Yes.

4 Q. Okay. And you are also aware that in that
5 decision the company indicated it was -- that it was in
6 a position where it was not able to provide adequate
7 utility service, agreed?

8 A. I am not sure on the particulars of the case.

9 MS. MITCHELL: A-13.

10 MR. WILEY: Is it A-13?

11 BY MR. WILEY:

12 Q. Will you find A-13.

13 A. Okay.

14 Q. A-13 is the Commission Decision No. 71447 which
15 is the Far West interim rate decision, correct?

16 A. Correct.

17 Q. Okay. Let me have you look at page 3 on lines
18 14 and 15. Are you there?

19 A. Uh-huh.

20 Q. Okay. And that indicates that there are 15,000
21 water customers and 7,300 sewer customers, agreed?

22 A. Agreed.

23 Q. Okay. That's comparatively sized to LPSCO,
24 agreed?

25 A. I think the numbers are a little bit different.

1 Q. I think LPSCO has got approximately 33,000
2 customers, fair?

3 A. Right.

4 Q. I mean on a comparison, for comparison purposes
5 would you agree that Far West is comparatively sized to
6 LPSCO?

7 A. It is a little bit less.

8 Q. But I mean when you are looking at affiliate
9 cost models, you would have to agree that Far West is
10 comparatively sized, fair?

11 A. Okay.

12 Q. And if you look at page 4 of that decision, on
13 line 15 there is a reference to system-wide odor
14 problems. Do you see that?

15 A. Yes.

16 Q. Okay. And on line 17 there is a line that says
17 Coriolis, which was the engineer hired by Far West,
18 found, quote, that Far West had many more issues besides
19 the Del Oro treatment plant, including issues facing the
20 water division. Do you see that?

21 A. Yes.

22 Q. Okay. Now, on page 7 there is reference to the
23 fact that Far West obtained approximately \$25 million in
24 IDA bonds. Do you see that?

25 A. Yes.

1 Q. Okay. And on page 8 there is a reference that
2 Far West incurred, quote, approximately \$1.3 million in
3 costs and fees to obtain the IDA bonds. Do you see that
4 on line 7?

5 A. Yes.

6 Q. Okay. For purposes of your testimony in this
7 case, Mr. Michlik, did you make any comparison to the
8 costs of obtaining other financing besides equity
9 financing from the Toronto Stock Exchange which is
10 provided by the Income Fund to LPSCO?

11 A. No, but neither did the company.

12 Q. Okay. Well, you are looking at a document right
13 here that indicates that it cost Far West \$1.3 million
14 in costs to obtained IDA bonds, agreed?

15 A. Agreed. It is just one company.

16 Q. Is it the company's obligation to go out and
17 find cases that disprove its allocation methodology?

18 A. No. It is the company's obligation to support
19 its position by providing -- or the company has the
20 burden of showing that its allocation method would be
21 fair when you compare it to more than one stand-alone
22 company.

23 Q. But you haven't identified any other stand-alone
24 companies that LPSCO should use to compare its
25 allocation methodology?

1 A. Not right here, but I am sure I can.

2 ACALJ NODES: Mr. Michlik, you are aware of the
3 existence of Arizona Water and Arizona-American,
4 correct?

5 THE WITNESS: Correct.

6 ACALJ NODES: You identified those previously.
7 And they operate a number of separate operating systems,
8 correct?

9 THE WITNESS: Yes.

10 ACALJ NODES: And so within that context, and
11 each of those systems has separate rate structures,
12 correct?

13 THE WITNESS: Correct.

14 ACALJ NODES: So the systems in effect are
15 operated as separate entities, even though they are
16 under a corporate umbrella of the parent company,
17 correct?

18 THE WITNESS: Correct.

19 ACALJ NODES: And to your knowledge, do either
20 Arizona Water or Arizona-American in their rate
21 structures have the type of corporate allocations for
22 which -- or similar to what is being requested in this
23 case by LPSCO?

24 THE WITNESS: I am not aware.

25 ACALJ NODES: Okay. Are you aware one way or

1 another?

2 THE WITNESS: No.

3 ACALJ NODES: Okay. And are you aware of
4 whether the Commission has in any prior case approved a
5 corporate allocation structure that is similar to the
6 type of allocation that is being sought in this
7 particular case? Has the Commission specifically
8 approved the type of corporate cost allocation?

9 THE WITNESS: No, I am not aware of that.

10 ACALJ NODES: Okay. And do you think that if
11 the Commission had specifically approved this type of
12 corporate allocation in a prior decision that you would
13 likely be aware of it?

14 THE WITNESS: Yes. And if that's the way the
15 Commission wants to go, we probably, if they had come up
16 with a basis of some other case and they stated that's
17 the way we want to proceed with this in future rate
18 cases, to have allocation, then yes, we probably would
19 have looked at that and maybe adopted that methodology.

20 ACALJ NODES: So, for example, the Global
21 companies are in for a rate case, but the Commission has
22 not made any ruling in that case, correct? It is still
23 pending?

24 THE WITNESS: It is still pending to my
25 knowledge, yes.

1 ACALJ NODES: And similarly, in the last Black
2 Mountain case, not the one currently pending but the
3 prior one, when Algonquin attempted to, when it proposed
4 a corporate cost allocation model, the Commission in
5 excluding the profit margin that had been requested
6 specifically said that it was concerned potentially with
7 the type of allocation that was being proposed, and it
8 expected some additional scrutiny by the parties in the
9 next Algonquin case, correct?

10 THE WITNESS: I thought that related to the
11 affiliate profit within the capitals was my
12 recollection.

13 ACALJ NODES: Okay.

14 THE WITNESS: The company as a consequence of
15 that case has actually removed the affiliate profit from
16 the plant in this case.

17 ACALJ NODES: Okay. Well, those -- the order
18 will speak for itself. I don't want you to speculate,
19 only if you were familiar with it.

20 So, all right, go ahead, Mr. Wiley.

21 BY MR. WILEY:

22 Q. Back to the Far West decision, Mr. Michlik, you
23 would agree that one of the fundamental problems that is
24 discussed in that decision is Far West's inability to
25 have access to capital to complete the various projects

1 that were at issue in the case, fair?

2 A. I am not familiar. I haven't read this
3 decision.

4 Q. All right. Let me find the references to it. I
5 was trying to short-circuit that.

6 ACALJ NODES: Well, Mr. Michlik, with respect to
7 the Far West decision, even if the Commission made
8 statements to the effect that this particular company
9 was perhaps poorly managed or there was some question
10 about the management's ongoing ability to complete a
11 particular construction project and operate the company
12 in a reasonable manner, that doesn't necessarily mean
13 that that specific company is necessarily representative
14 of all the other stand-alone utility companies, is it?

15 THE WITNESS: No, you are correct. You can't
16 use this one case and say all Arizona water and
17 wastewater companies are run in a similar fashion.

18 ACALJ NODES: There are poorly managed
19 individual companies and there are well managed
20 individual companies, and companies that are in between?

21 THE WITNESS: Correct. I would agree with that,
22 yes.

23 ACALJ NODES: All right.

24 BY MR. WILEY:

25 Q. Just a couple more questions on Far West,

1 Mr. Michlik, and I will move on. Let me have you look
2 at page 26, line 6 through 8.

3 MS. MITCHELL: What page was that?

4 MR. WILEY: 26, lines 6 through 8.

5 BY MR. WILEY:

6 Q. It says, quote: Given the company's high
7 leverage and ongoing disputes with ADEQ, it would appear
8 to be an unlikely candidate to receive additional debt
9 or equity capital. Having depleted its options for
10 additional debt and its ability to obtain additional
11 capital from the shareholders, Far West turns to its
12 ratepayers for a bailout.

13 Do you see that line?

14 A. Yes.

15 Q. Okay. You would agree, Mr. Michlik, that one of
16 the risks of a stand-alone company is that many of them
17 are highly leveraged with not a lot of equity in the
18 capital structure, agreed?

19 A. May or may not be. It just depends on the
20 specific company.

21 Q. Well, you are working currently on the Johnson
22 Utilities case, correct?

23 A. Yes.

24 Q. And Johnson Utilities is a stand-alone entity?

25 A. Yes.

1 Q. And that has a capital structure of
2 approximately 91 percent debt and 9 percent capital,
3 agreed?

4 A. I agree. But I don't think you can make that
5 comparison against all companies in Arizona.

6 Q. Okay. Well, I am just citing that as an
7 example. I am not necessarily looking to use Johnson
8 Utilities for anything other than recognizing that it is
9 important to have access to capital equity. Agreed?

10 A. The particulars in that case were also
11 different. It was a choice by the company on whether to
12 actually put equity in a company or rely on hookup fees.
13 And that's the way the company decided to basically fund
14 the company, was through hookup fees.

15 Q. And Johnson Utilities also has a negative rate
16 base, correct?

17 A. Correct.

18 Q. Okay. Now, one benefit --

19 A. The reliance on the hookup fees.

20 Q. Essentially they were taking a lot of CIAC and
21 infusing the CIAC in their capital structure which
22 ultimately resulted in the highly leveraged capital
23 structure, fair?

24 MS. MITCHELL: I need to not interpose an
25 objection or, well, clarification, but I believe the

1 schedules changed and they may or may not have had
2 negative rate base by the time we filed the final
3 schedule, which is why it is so dangerous to sit here
4 and compare one company against another one in one case
5 against another case.

6 MR. WILEY: Do I need to respond to that? I
7 mean the whole premise of Mr. Michlik's testimony was
8 comparisons to other stand-alone utilities, and I am
9 just simply exploring a comparison to one utility that
10 Mr. Michlik is currently working on.

11 ACALJ NODES: All right. Go ahead.

12 MS. MITCHELL: Well, it is just difficult
13 because that was not the only premise, that was one of
14 them. And, you know, when you start to cite facts from
15 cases that may or may not be true, it puts the witness
16 at a disadvantage in trying to answer that question.

17 MR. WILEY: If it helps, Ms. Mitchell, I am
18 about to move on.

19 MS. MITCHELL: That would help.

20 BY MR. WILEY:

21 Q. Mr. Michlik, the point I guess I was trying to
22 make was: You would agree whether it is a stand-alone
23 or an affiliate structure, an entity and its ratepayers
24 benefit by access to equity capital, agreed?

25 A. When you say necessarily all equity, there has

1 to be a mix of equity and debt, but...

2 Q. But you would agree with the general principle
3 that it is beneficial for a utility and its ratepayers
4 to have access to equity capital to be infused into the
5 company; whether that's all equity or less equity, the
6 access to equity capital is a benefit, agreed?

7 A. Well, it just all depends, because if it is all
8 equity, then when you do a cost of capital analysis, the
9 rate of return is going to be much higher, but I think
10 you need a blend of so much debt and so much equity.

11 Q. Well, irrespective of the ultimate ratemaking
12 treatment of the cost of capital, you would agree that
13 it benefits the utility to actually have access to
14 capital for equity, agreed?

15 A. Without regards to the specific amount, I would
16 say yes, it is probably good for companies to have
17 access to equity.

18 Q. To put it simply, Mr. Michlik, having capital to
19 build adequate plant is a benefit to ratepayers, fair?

20 A. Well, again, it depends on in what proportion.
21 If it is all capital, then it wouldn't benefit
22 ratepayers because they are ultimately going to pay for
23 that in higher rates. So I would say yes, some equity,
24 some debt.

25 Q. Now, if you are using a stand-alone comparative

1 model for the cost allocations, shouldn't the proper
2 deduction out of operating costs be the difference
3 between the costs incurred by a stand-alone entity and
4 the costs incurred by LPSCO?

5 A. Well, we would have to examine your cost pools
6 and determine who they benefit. And then if they do
7 benefit, in this case we have, we have cited if they do,
8 if there is some type of benefit then we have allocated
9 it down.

10 Q. I am not sure that answered my question,
11 Mr. Michlik. I guess what I am saying is this. Let's
12 assume that a stand-alone utility incurs approximately
13 \$60,000 in tax services during a year. Okay? Can you
14 make that assumption?

15 A. Yes.

16 Q. If LPSCO incurs \$100,000 in tax costs, okay,
17 then your position would be the \$100,000 is in excess of
18 the cost incurred by the stand-alone utility, agreed?

19 A. Well, it depends on what type of -- you have to
20 look -- you know, if it is, I guess what you are trying
21 to say is if it is comparable to these five Arizona
22 Water companies on a stand-alone basis, then it probably
23 should be for your company, is what you are saying.

24 Q. I guess what I am saying is if a stand-alone
25 company incurs tax costs for 60,000 and LPSCO incurred

1 tax costs for 100,000, the deduction should be \$40,000,
2 which is the difference between the two costs, as
3 opposed to simply deducting the entire amount that LPSCO
4 has put in its cost allocation model. You would agree
5 with that, correct?

6 A. If it is on a stand-alone basis, yes.

7 Q. Okay. And that would apply --

8 A. And it is necessary for the provision of water
9 and wastewater services.

10 Q. Right. And that would apply to all of the costs
11 that would be necessary for providing utility service,
12 agreed?

13 A. Agreed.

14 Q. Okay. You talked about the NARUC guidelines for
15 cost allocations and affiliate transactions in your
16 testimony, correct?

17 A. Correct.

18 Q. Okay. That's just a guidance document provided
19 by NARUC, fair?

20 A. Correct.

21 Q. And I think those were issued in 1998?

22 A. I don't know.

23 Q. Okay. Has Staff adopted those guidelines for
24 purposes of evaluating affiliate cost allocations?

25 A. I guess what do you mean by the term adopt? I

1 mean we have used them in the Black Mountain, we used
2 them in this case, we are using them in the Rio Rico
3 case.

4 Q. Has Staff written them into any possible
5 published policies, guidelines, rules, or regulations?

6 A. Not to my knowledge.

7 Q. I think, in your view, has LPSCO complied with
8 the NARUC guidelines?

9 A. No.

10 Q. Okay. In what respects has LPSCO not complied
11 with the NARUC guidelines?

12 A. Some of the cost pools could have been broken
13 down better and directly costed.

14 Q. Which ones?

15 A. For example, some of your professional services
16 just related to maybe Canadian issues, power, wind
17 generation, hydro, and really have nothing to do with
18 water or wastewater.

19 Q. Is there anything else that LPSCO has done that
20 failed to comply with the NARUC guidelines?

21 A. Under allocation principles, to the maximum
22 extent practical in consideration of administrative
23 costs, costs should be collected and classified on a
24 direct basis for each asset service or product provided.

25 Q. Okay. So how did LPSCO violate that principle

1 of the NARUC guidelines?

2 A. I have already stated that. You are investing
3 in energy, hydro, wind. I am not sure how those
4 would -- how those are directly assignable to a water
5 and wastewater company.

6 Q. Well, what specific costs for wind generation
7 and hydro were included in the central office cost pool?

8 A. I would have to go back and look at my
9 documents. There were several.

10 Q. Did you anywhere itemize or list those costs
11 that were for wind generation or hydro in the cost
12 allocation pool?

13 A. No.

14 Q. Okay. When you were making your decisions as to
15 what should be deducted from operating expenses for
16 affiliate costs, you didn't use any specific costs for
17 wind and hydro that were included in the cost pool,
18 fair?

19 A. Correct.

20 Q. That's the same with energy, true?

21 A. Correct.

22 Q. So in other words, you don't know what costs
23 were included in the cost pool for energy services or
24 facilities undertaken by the income fund, fair?

25 A. No. We did note that there were costs included

1 for those water, or, excuse me, hydro, energy and wind.

2 Q. But you didn't separately itemize them for
3 purposes of calculating deductions from the operating
4 expenses, fair?

5 A. That's right. We just disallowed the whole
6 pool.

7 Q. I think in one of the data responses,
8 Mr. Michlik, you had indicated that aside from equity
9 funding from the Toronto Stock Exchange there were other
10 sources of funding available to LPSCO, correct?

11 A. Which data request are you referring to?

12 Q. I will give it to you later. I just want to
13 sort of get into the general principle. I am not going
14 to ask you specifically about that data request right
15 now. But I just wanted to ask you if you recall that
16 general subject being raised in the data request.

17 MS. MITCHELL: Excuse me, Mr. Wiley. If you are
18 going to give it to him later, isn't sooner better, so
19 he can at least maybe intelligently answer your
20 question?

21 MR. WILEY: Let me try and make a generic
22 question, Ms. Mitchell.

23 MS. MITCHELL: Okay.

24 BY MR. WILEY:

25 Q. Mr. Michlik, the funding that LPSCO uses for

1 capital projects is equity funding provided by the
2 Income Fund, correct?

3 A. Correct.

4 Q. Okay. What other sources of capital funding for
5 projects is available to LPSCO?

6 A. Again, LPSCO has IDA bonds, there is WIFA
7 funding.

8 Q. Is there anything else?

9 A. I am sure there are a few other items, but I
10 just can't recall right now.

11 Q. What other sources of equity capital is
12 available to LPSCO?

13 A. I think I have already stated the WIFA, the IDA
14 bonds. There may be other bonds available.

15 Q. WIFA, and IDA bonds aren't equity, they are
16 debt, right?

17 A. Debt, right.

18 Q. So my question is: What other sources of equity
19 funding is available to LPSCO?

20 A. Well, there could be an equity infusion from the
21 officers of the company.

22 Q. Okay. And other than equity funding from
23 officers of the -- well, officers of which company?

24 A. Well, it would depend. I mean you have API,
25 APITF, you have a bunch of affiliates, several layers.

1 Q. Okay. So you are suggesting that there would be
2 equity infused from other affiliates of LPSCO, is that
3 what you are suggesting?

4 A. No. I mean the company, the company has its
5 structure that all their equity is coming from their
6 shareholders in the Toronto Exchange.

7 Q. I guess --

8 A. But your question was could they structure it
9 differently. Yes, and I just answered that.

10 Q. Well, I think you got off track on my question.
11 What I am asking you, Mr. Michlik, is what other sources
12 of equity funding for capital projects is available to
13 LPSCO as we sit here today?

14 A. The way LPSCO is set up, they receive funding
15 through APIF.

16 Q. So you would agree that the only source of
17 equity funding is through money provided by the income
18 fund through sales of units or shares on the Toronto
19 Stock Exchange?

20 A. Currently. But the company could go to some
21 other methodology.

22 ACALJ NODES: The reason, and I think you have,
23 you have suggested this, is if LPSCO, for example, were
24 a stand-alone company, its equity would be infused by
25 whoever the shareholders were, correct?

1 THE WITNESS: Exactly.

2 ACALJ NODES: And it is only because of the
3 corporate structure that Algonquin has --

4 THE WITNESS: Has chosen.

5 ACALJ NODES: -- chosen is why the equity is
6 only available from that single source, correct?

7 THE WITNESS: Correct.

8 BY MR. WILEY:

9 Q. Mr. Michlik, you haven't evaluated the costs of
10 private equity infusions by owners or shareholders of a
11 utility, correct?

12 A. No. Neither has the company.

13 Q. Okay. So in other words, when Judge Nodes just
14 asked you about the differences between other types of
15 utilities which have equity infused by their owners as
16 it compared to LPSCO, there is no analysis of the
17 comparative costs of either sources of equity, agreed?

18 A. I didn't do an analysis on that, no.

19 Q. Okay. Let's look back at page 17 of your
20 testimony, on lines 23 to 24. Tell me when you are
21 there. Are you there?

22 A. Yes.

23 Q. You have got a line that says, quote, Staff
24 determined that almost all of the costs were obviously
25 attributable to the operations of the APIF or one of its

1 affiliates; therefore, Staff assigned 90 percent of the
2 cost to APIF. Do you see that line?

3 A. Yes.

4 Q. Okay. Did you do anything other than look at
5 the invoices to make that determination?

6 A. No. We asked the company in a data request.
7 The company responded back. We looked at the invoices.
8 All the invoices were billed to the company in, I
9 believe it is, Oakville, Ontario.

10 Q. Okay. So if the invoices would have referenced
11 LPSCO, then they would not -- then they would not be
12 attributable to the income fund?

13 A. Well, if we could determine that, if they were
14 for services that LPSCO customers received and were
15 billed to LPSCO, yes, then we probably would have
16 included them.

17 Q. Okay. And Ms. Mitchell asked you some questions
18 when she was introducing your testimony about how you
19 came up with the 90 percent versus 10 percent
20 calculation. Do you recall that question?

21 A. Correct.

22 Q. Okay. My understanding of the way you come up
23 with that is you just simply determined that 90 percent
24 of the affiliate costs are attributable to the income
25 fund and its shareholders and 10 percent were of

1 peripheral benefit to LPSCO, correct?

2 A. I think, yes -- it continues on to page 18 --
3 but again, that's only 10 percent of certain pools.

4 Q. Okay. Exactly how did you make that
5 calculation?

6 A. The 10 percent?

7 Q. Yes.

8 A. I think we stated on page 18 the remaining
9 10 percent recognizes the other affiliates received a
10 benefit from common cost and, therefore, should be
11 allocated in a percentage greater than zero. We said
12 10.

13 Q. But I guess what I am asking, how did you come
14 up with a 10 percent figure? I mean, how did you
15 literally make that calculation?

16 A. It is 10 percent.

17 Q. You just simply determined it was 10 percent on
18 your own?

19 A. Yes.

20 Q. And that's based on your experience?

21 A. It is based on Staff experience. And, you know,
22 maybe it is 1 percent, you know. I think we are being
23 quite generous with 10 percent.

24 Q. Did you perform any studies of the time engaged
25 by the, in the time engaged or involved with the APT

1 costs during a representative period of time?

2 A. I am not sure what you mean. Can you rephrase
3 that question.

4 Q. Sure. I think that was a poorly worded
5 question. Did you perform a study of the cost incurred
6 in a time spent engaged on, engaged by the APT services
7 model during a representative period of time?

8 A. One more time.

9 Q. Sure. Did you undertake any study of the costs
10 actually incurred and the services actually provided by
11 APT during any period of time?

12 A. We asked for that in a data request, provide us
13 all your invoices within the test year, so I would say
14 yes.

15 Q. Okay. So show me the study that you undertook
16 of the costs incurred by APT and the services provided
17 during any period of time.

18 A. We have that. It is in my schedule.

19 Q. So the schedule is the study that you undertook?

20 A. Yes.

21 Q. Mr. Michlik, you would agree that the company
22 doesn't have any burden of proof to support Staff's
23 adjustment to the affiliate cost allocations, agreed?

24 A. Agreed.

25 Q. Okay. Staff has its own burden of proof to

1 support its own adjustments to the affiliate cost
2 methodology and allocations, fair?

3 A. I think we have already supported it in our
4 direct and surrebuttal testimony, and that's why we are
5 here at the hearing.

6 Q. Okay. But you would agree that Staff has its
7 own burden of proof to support its adjustments to
8 affiliate cost allocation in this case, agreed?

9 MS. MITCHELL: If we are going to talk about
10 burden of proof, Mr. Michlik really isn't like an
11 attorney here. So it is like a legal kind of conclusion
12 on burden of proof.

13 ACALJ NODES: Mr. Wiley.

14 MR. WILEY: He already stated about five or six
15 times during his testimony that the company didn't meet
16 its burden of proof on these issues. I am using the
17 words from his own testimony.

18 MS. MITCHELL: I know, but you are asking him to
19 draw a legal conclusion versus what everybody knows that
20 the company has to carry forth its application.

21 MR. WILEY: Judge, I am using the words from his
22 own testimony here today.

23 ACALJ NODES: Well --

24 MR. WILEY: I can re --

25 ACALJ NODES: You are turning it now to burden

1 of proof in a general sense the company bears by its own
2 admission. And I think everybody understands that. But
3 now when you move to, okay, what burden of proof does
4 Staff have in a specific situation, then I think you
5 have gone to the point of asking essentially for a legal
6 conclusion.

7 MR. WILEY: I will be happy to rephrase the
8 question based upon his experience.

9 BY MR. WILEY:

10 Q. Mr. Michlik, based upon your experience as a
11 rate analyst, Staff has its own burden to demonstrate
12 the appropriateness of its own adjustments to the cost
13 allocations provided by LPSCO, agreed?

14 A. Staff in its direct, surrebuttal testimony, and
15 in hearings, you know, we explain why we have made these
16 adjustments.

17 Q. But you would agree that Staff has its burden to
18 support its own deductions from operating expenses on
19 the cost allocation issues?

20 MS. MITCHELL: Excuse me, before he answers. I
21 don't think that rephrased it well enough.

22 ACALJ NODES: Just ask him if he believes Staff
23 needs to support its testimony and recommendations. I
24 think it is to the same point --

25 MR. WILEY: What --

1 ACALJ NODES: -- as does every other party.

2 BY MR. WILEY:

3 Q. What the judge just said, Mr. Michlik.

4 A. Yes. And that's what I believe I was trying to
5 explain in our direct testimony. We state why we
6 disallow an adjustment. And, you know, if we get some
7 more evidence or something from the company, sometimes
8 we reverse a position, sometimes we change our
9 positions. And there is surrebuttal. Sometimes we
10 change them on the stand in hearings.

11 Q. Let's focus a minute on the actual cost
12 allocated down from APT. Now, when you said in your
13 testimony that the costs from APT were incurred
14 primarily -- well, let me rephrase that.

15 Your testimony includes statements indicating
16 that it was your conclusion that the costs incurred by
17 APT were incurred primarily for the benefit of the
18 income fund and its shareholders, correct?

19 A. Correct.

20 Q. Okay. How did you come to that conclusion?

21 A. By analysis of the invoice that was provided
22 Staff in a data request.

23 Q. Okay. So you base that testimony entirely on
24 the wording on the invoices that LPSCO provided in
25 support of the cost allocations, fair?

1 A. And in other data requests that we sent to the
2 company.

3 Q. Okay. So the wording the data request responses
4 by LPSCO and the invoices actually provided, fair?

5 A. Fair.

6 MR. WILEY: Can we have like a brief break? I
7 might be close here, but I just need to organize my
8 notes.

9 ACALJ NODES: Okay.

10 MR. SHAPIRO: We just need a minute.

11 ACALJ NODES: Yes. We will just take a
12 10-minute break here. And off the record.

13 (A recess ensued from 2:10 p.m. to 2:22 p.m.)

14 ACALJ NODES: Okay. Mr. Wiley.

15 MR. WILEY: Yes, Judge. I just have one more
16 question on affiliate cost, then I will turn it over to
17 Mr. Shapiro.

18 BY MR. WILEY:

19 Q. Mr. Michlik, if the Commission adopts your
20 methodology and denies the APT -- denies the cost
21 allocations for the services provided by APT, then APT
22 could stop providing those services associated with
23 those costs, agreed?

24 A. It would be the company's decision. We can't
25 run companies here, so it would be up to the company.

1 MR. WILEY: Okay. No more questions, Judge.

2 ACALJ NODES: Mr. Shapiro.

3 MR. SHAPIRO: Yes, there was no more questions
4 on central costs.

5

6 CROSS-EXAMINATION

7 BY MR. SHAPIRO:

8 Q. Do you have Exhibit S-18 up there, Mr. Michlik?

9 ACALJ NODES: What was it again, Mr. Shapiro?

10 MR. SHAPIRO: It is the Matthew Bender document
11 that he introduced this morning.

12 ACALJ NODES: 18?

13 MR. SHAPIRO: S-18.

14 ACALJ NODES: Okay.

15 THE WITNESS: Okay.

16 BY MR. SHAPIRO:

17 Q. You didn't include this document in your work
18 papers, correct?

19 A. Correct.

20 Q. You didn't cite this document in your prefiled
21 testimony, correct?

22 A. Yeah. It was an oversight on my part; it should
23 have been cited.

24 Q. When did you find this document and rely on it?

25 A. I believe in the surrebuttal testimony.

1 Q. So you made the adjustment and then found
2 authority to support it?

3 A. Yes.

4 Q. And Staff follows all of the Matthew Bender
5 principles for accounting for public utilities
6 consistently?

7 A. I am not going to say in every case, but
8 generally we try to follow, because there are several
9 different ways. For instance, you could have used the
10 customer deposits and your weighted average cost of
11 capital. But Staff traditionally uses a reduction from
12 rate base so...

13 Q. Can you reference to any other Commission
14 decisions where the Commission specifically addressed
15 and included security deposits as an offset to rate
16 base?

17 MR. CARLSON: Hundreds.

18 MR. SHAPIRO: If Mr. Carlson could avoid
19 testifying from over there, that would be appreciated.

20 ACALJ NODES: Mr. Carlson, if you are going
21 to -- please whisper --

22 MR. CARLSON: I apologize. I wear a hearing aid
23 and I tend to whisper loudly.

24 ACALJ NODES: It was able to be heard. So we
25 need to let the witness testify on his own accord.

1 MS. MITCHELL: Oops.

2 THE WITNESS: Staff did make a deduction for
3 customer deposits in the Arizona Water case. I think
4 that one is still pending. There was a reduction from
5 rate base from customer deposits.

6 BY MR. SHAPIRO:

7 Q. And in this case, where is the adjustment that
8 you made to plant in service to offset your adjustment
9 for security deposits?

10 A. You said deduction from rate base?

11 Q. So you didn't do any offsetting adjustment?

12 A. If you are referring to the interest expense --

13 Q. No. I am referring to -- well, if you include
14 AIAC as an offset to rate base, you include plant in
15 service, correct?

16 A. No, it is a deduction. AIAC/CIAC are
17 deductions. Customer deposits are a deduction
18 because -- or else you would be earning a return on, the
19 company would be earning a return on money that's not
20 theirs.

21 Q. Well, they would only be earning a return on it
22 if the company included security deposits in a rate
23 base, right?

24 A. Well, it is in rate base. That's where we are
25 pulling it out.

1 Q. Okay. The company will only be earning a return
2 on it if cash was included in rate base, correct?

3 A. No. I mean this is -- deposits are available to
4 the utility for use in its support of its rate base
5 investment.

6 Q. Well, how does the company, if the company gets
7 a security deposit from a customer, sticks it in the
8 bank, how does it use that to support its rate base?

9 A. Well, it can't. All it says is funds received
10 can be used to support the rate base. So you could buy
11 a piece of plant with those customer deposits.

12 Q. Do you know if LPSCO has done anything except
13 for leave customer deposits, including security
14 deposits, in the bank?

15 A. I don't know.

16 ACALJ NODES: Mr. Michlik, are you aware of
17 several recent decisions in which the Commission has
18 specifically rejected the argument that CIAC and AIAC
19 should not be, or Commission accepted the argument by
20 Staff that AIAC and CIAC should be deducted from rate
21 base even if there is not a corresponding piece of plant
22 that has actually been built and included in rate base
23 associated with the CIAC and AIAC?

24 THE WITNESS: Yes. I believe that's H₂O.

25 ACALJ NODES: H₂O and some other cases as well,

1 correct?

2 THE WITNESS: Yes.

3 ACALJ NODES: Okay.

4 BY MR. SHAPIRO:

5 Q. Is there any reference in the Commission's rules
6 regarding rate filings that explains to a company where
7 customer and security deposits are to be treated and
8 placed?

9 A. I am not sure.

10 Q. Wouldn't you think that would be something that
11 the company should be directed to do if there is a
12 standard practice that the Commission requires?

13 A. I think it is something the company should
14 probably do on its own.

15 Q. The company should -- I am sorry, may be
16 confusing me. The company should decide what the
17 Commission wants on its own?

18 A. Well, you are stating can the company go back
19 and specifically find where customer deposits are not
20 allowed --

21 Q. Well --

22 A. -- in the administrative code. That's your
23 question back, so...

24 Q. Mr. Michlik, I am asking you a question. Can
25 you point to the Commission's rules and identify for me

1 where the treatment that you are recommending is set
2 forth in the rules?

3 A. No, but I -- on the contrary, too, there is
4 nothing in the rules that state that it shouldn't be
5 included either.

6 Q. There is nothing in the rules that cost
7 allocation should or shouldn't be included either,
8 right?

9 A. Right.

10 Q. What is the test year in this case, Mr. Michlik?

11 A. September 30th --

12 Q. And --

13 A. -- 2008.

14 Q. Thank you. I am sorry.

15 And the annual reports that you are relying on
16 for your deferred income tax calculation, they don't
17 match up to the test year, do they?

18 A. It is three months later, but it is the same
19 amount.

20 Q. Well, it is the same amount because you are
21 using the same amount?

22 A. No.

23 Q. Well, Mr. Bourassa calculated a different
24 amount, didn't he?

25 A. He made a pro forma adjustment.

1 Q. Well, did you address -- did you take into
2 account post test year plant when you did your deferred
3 income tax calculation relying on the annual report?

4 A. No, but we asked the company for supporting
5 documentation for the 335,400 and some odd thousand
6 dollars, and the company didn't provide it to us.

7 Q. Well, that wasn't my question. My question was:
8 Did you take into account post test year plant in your
9 reliance on the annual report to come up with the
10 deferred income tax number?

11 A. Well, I would have to look at that number. We
12 asked the company for it, see if it was included in
13 there.

14 Q. Well --

15 A. We weren't given that information, so I don't
16 know if, if that number is in there or not.

17 Q. Well, Mr. Bourassa explained in some detail in
18 his testimony how he did his deferred income tax
19 calculations. What don't you have to verify that?

20 A. Well, we would like the starting numbers of the
21 335,000. We have asked that from the company. The
22 company has not supplied that to us.

23 Q. Can you tell me where you have asked for that.

24 A. Yes. In data request JMM 1.55, deferred income
25 taxes and credits, please provide Staff with a breakout

1 of what is included in deferred income taxes and credits
2 in the amount of \$335,487, i.e. tax credits, loss carry
3 forwards, et cetera. Response: The 335,487 is the 2006
4 number and was trued up by Mr. Bourassa per his Schedule
5 B-2, page 5.

6 JMM 1-8 asks the same question and refers to the
7 question I just read.

8 We asked for deferred income tax expense,
9 provide all M schedules and the respective amounts used
10 in calculating the company's income tax expense; some of
11 those numbers should be reflected in deferred income tax
12 credit. Response: See the attached schedules for the
13 deferred income tax calculation along with the detailed
14 listings from the 2007 tax return for opening UCC
15 balance.

16 We followed up with a data response JMM 8-1,
17 deferred taxes and credits. This is a follow-up to data
18 request JMM 1-55, which asks the following: Please
19 provide Staff with a breakout of what is included in
20 deferred taxes and credits in the amount of \$335,487,
21 335,487, tax credits, loss carry forwards, et cetera.
22 The company responded: The 335,487 is a 2006 number and
23 was trued up by Mr. Bourassa per schedule B-2, page 5.

24 This was not responsive to the Staff's data
25 request. Please provide documentation that clearly

1 describes the components from which this dollar amount
2 was derived.

3 Response was: The 335,487 deferred incomes tax
4 expense is based on prior year deferred tax amount and
5 was split, of 670,974 split 50/50 between the water and
6 sewer division and is irrelevant. The proposed deferred
7 income tax amount of 37,458 represents the deferred
8 income tax at the end of the test year. Since that time
9 that number has changed. The company's computation
10 follows FASB 109 accounting for income taxes. The
11 670,974 prior year amount is irrelevant. The company
12 includes in the attached file the 2006 deferred income
13 tax component. A deferred amount shown is 685,538.
14 This is somewhat higher than the amount booked of
15 670,974 for 2006. The difference is due to audit
16 adjustments made after 2006.

17 But you didn't give me any documentation or any
18 of the numbers summed up to that amount.

19 Q. Well, Mr. Bourassa did that in his testimony,
20 didn't he, at rejoinder Schedule B-2, page 5 and 5.1?
21 Didn't he show you his reconciliations to support his
22 calculation of accumulated deferred income taxes?

23 A. Those are his calculations. Again, those came
24 pretty late in rejoinder testimony, so I wasn't able to
25 fully review those.

1 I do think they probably do match the time
2 difference between book and tax values. However, as I
3 look at the KPMG independent auditor's report, which was
4 done for Litchfield on December 31st, 2008, the net
5 deferred tax liability report of their 504,528, that's a
6 different number. So none of these numbers correlate to
7 every one.

8 And then I believe the auditors did do the
9 calculation right. KPMG takes the deferred asset and
10 nets it against deferred liability to come up with a net
11 deferred tax liability. If you look at the deferred tax
12 assets of 2008, this amount includes tax losses of 3.5,
13 3,540,989. And this information was not in
14 Mr. Bourassa's calculation.

15 And I would also like this number to be
16 referenced to his rejoinder testimony and see what
17 components he has used and why the numbers don't match
18 to this.

19 Q. You want a --

20 A. A reconciliation.

21 Q. To an independent audit that is for a year that
22 does not match the test year, correct?

23 A. Well, yes. I understand there is a slight
24 timing difference. Well, okay. This was the result of
25 a timing difference. This isn't included.

1 Q. So you think that Mr. Bourassa's rejoinder
2 analysis is probably correct; however, it doesn't match
3 another document you have from somebody else that is not
4 a specific calculation of test year deferred income
5 taxes. And because it is not reconciled, you can't take
6 a position to agree with Mr. Bourassa. Is that my
7 understanding of your position?

8 A. At this point, yes.

9 Q. Okay, thank you.

10 ACALJ NODES: Mr. Michlik, as I understand it,
11 the annual report for the year ending 2008 still
12 reflects the 335 split between water and wastewater,
13 correct?

14 THE WITNESS: Yes.

15 ACALJ NODES: 335,000. And if it were a
16 different number as of -- and then the auditor, you
17 suggested, had yet a different number?

18 THE WITNESS: Yes.

19 ACALJ NODES: For the end of 2008, why, if it
20 is, if the deferred income tax for the test year was
21 different than this number, would the company continue
22 to use this even as of the end of 2008?

23 THE WITNESS: That's my question. I don't know.

24 ACALJ NODES: So that's where the confusion came
25 in from your perspective.

1 THE WITNESS: Yes.

2 ACALJ NODES: That even though as of the end of
3 the test year they are now arguing for a different
4 number in what was reflected even three months after the
5 test year, the company itself was still using the
6 335,000.

7 THE WITNESS: Right. It is kind of like a
8 moving target. And in the direct testimony a number was
9 adjusted, rebuttal testimony the number was adjusted
10 actually higher. Now, on the rejoinder, it is somewhere
11 in between. So...

12 ACALJ NODES: Okay. All right.

13 Go ahead, Mr. Shapiro.

14 BY MR. SHAPIRO:

15 Q. Mr. Bourassa explained those adjustments as well
16 as being, one, responsive to Staff's position in another
17 pending docket for an affiliate, and, two, being the
18 result of changes he made in the elements of rate base,
19 correct?

20 A. I think if you are referring to the Rio Rico
21 case, there was still some dispute with Staff and the
22 company as to loss carry forwards.

23 Q. No, Mr. Michlik, I was referring to Ms. Brown's
24 position in Black Mountain that the company didn't
25 properly do it because it didn't roll it forward, I am

1 sorry, roll it back.

2 So did Mr. Bourassa do it both ways in this case
3 in response to that position expressed by Staff?

4 A. Yeah. But I would still like to kind of be able
5 to reconcile all the numerous numbers. I guess the one
6 that is in the original application at the end of the
7 test year, the one that's three months later is the
8 same. The KPMG number is different. So for me, I am
9 not satisfied.

10 Q. How did you account for the nearly \$5 million of
11 AIAC that the company received after the test year in
12 this case?

13 A. We didn't do our own separate calculation.

14 Q. Well, back to Judge Nodes' question, you would
15 agree with me that a post test year AIAC payment of
16 significance would have a significant impact on the
17 calculation of deferred income taxes, wouldn't it?

18 A. It may.

19 Q. So there may be things that occurred between
20 October 1 and 12/31/08 that could have affected the
21 calculation of deferred income taxes on a yearend basis,
22 correct?

23 A. Correct. And what I need is more information to
24 reconcile everything.

25 Q. Is that something you are willing to sit down

1 with Mr. Bourassa after the hearing and attempt to do?

2 A. I have other cases, so...

3 Q. Is that a no?

4 A. Yes.

5 Q. You said in your comments earlier today that
6 there was nothing precluding the company from seeking
7 recovery of the cost to test and participate in the
8 process, the Superfund process, in a future rate case,
9 correct?

10 A. I am not sure if -- we are not guaranteeing that
11 all those costs were recovered. We will certainly look
12 at those costs in a future rate case and see which ones
13 are reasonable.

14 Q. But you, of course, are perfectly comfortable
15 with the company not incurring costs that it is not
16 going to recover, right?

17 A. We don't know if they are not going to recover
18 or not. You are asking me to speculate.

19 Q. If the company is concerned, based on the facts
20 they couldn't recover them now, they won't recover in
21 the future, it is perfectly acceptable to stop incurring
22 those cost, right?

23 A. I mean, if the company wants to stop incurring
24 the costs, I guess they can write another accounting
25 order, ask that accounting order to be rescinded maybe.

1 I don't know.

2 Q. Well, an accounting order doesn't force the
3 company to incur costs, that allows them --

4 A. Track it.

5 Q. -- to track costs?

6 A. Yes.

7 Q. Right. And you would agree with me as a general
8 principle that if a utility is incurring costs that it
9 is not allowed to recover, it shouldn't have to keep
10 incurring those costs, should it?

11 A. How will we know the company is not going to
12 recover those costs?

13 Q. How will it know it will, Mr. Michlik? It has
14 already been in once and been told no.

15 MS. MITCHELL: I believe he has answered. He
16 said that, you know, you may or may not.

17 ACALJ NODES: All right. Let me ask you,
18 Mr. Michlik. This kind of concerns me, too. The
19 Commission -- and I guess why it concerns me is it seems
20 to me we have in this instance really a safety issue.
21 It is, would you agree with that, a --

22 THE WITNESS: Yes.

23 ACALJ NODES: -- potential safety issue?

24 THE WITNESS: Yes.

25 ACALJ NODES: And shouldn't the Commission --

1 and I think the Commission recognized the possibility,
2 the issue of safety when it authorized the accounting
3 order to encourage the company to be proactive in
4 continuing to monitor the plume and to take whatever
5 action was necessary in order to make sure that there
6 was no encroachment that would potentially cause the
7 company's customers to have unhealthy water or dangerous
8 water, correct?

9 THE WITNESS: Correct.

10 ACALJ NODES: And so I guess I am not -- and
11 although there was some language in the accounting order
12 about the company should seek compensation from the
13 responsible party, the company is kind of in a Catch-22,
14 isn't it, in the sense that it needs to incur these
15 expenses on an ongoing basis to make sure that the
16 public safety is protected, but there is no recognition
17 for collection of those costs for what appears to be is
18 going to be a fairly lengthy period of time?

19 And the company -- and if you don't allow
20 recovery, you are essentially telling the company -- I
21 mean they probably have to continue to do the monitoring
22 anyway, but why is that not a legitimate expense that
23 should be recovered on a, you know, timely basis since
24 they are in here for a rate case? I guess that's the
25 question.

1 THE WITNESS: There is too many unknowns at this
2 point. Maybe, you know -- I hope this doesn't happen,
3 but if this plume does actually get into LPSCO's water
4 supply, then they probably have to, you know, build new
5 wells, acquire new water sources. And I think that was
6 their legal position, actually once it invaded their
7 water supply, then they could actually go after the
8 third-party polluter.

9 However, on the other hand, maybe this
10 extraction well might work. And if they -- you know, we
11 don't know yet. In the future if it does and this plume
12 hasn't moved, then maybe that's the point at which time
13 we should decide or make some judgment on what costs
14 should be recovered.

15 ACALJ NODES: Well, but isn't the remedy more
16 properly to allow them to recover the ongoing costs, and
17 at the time there is actually a cause of action, and I
18 won't say -- let me retract cause of action -- at the
19 time that there is a reasonable opportunity to pursue
20 some kind of action against the responsible party and
21 there is some actual collection, then that money should
22 be used to offset what was previously collected for
23 these ongoing monitoring efforts? Isn't that the better
24 solution, so that ratepayers are ultimately made whole
25 and the company is made whole, and we are still in

1 position, the Commission would be, of encouraging the
2 company to take responsible action on an ongoing basis
3 and allow them to recover those reasonable costs so to
4 ensure the public health and safety?

5 THE WITNESS: I think there was some type of
6 expectation laid out in the company's original
7 application for the accounting order that there would be
8 recovery from the third party. I think what the company
9 wants to do now is have ratepayers pay now, then if they
10 get any recovery later and kind of try to offset. And
11 Staff's approach is to have -- hold the ratepayers
12 harmless, and then we can judge in a later rate case, we
13 will have better facts where we can determine how this,
14 how this amount should be recovered, or if it should be
15 recovered.

16 ACALJ NODES: Okay. But isn't an alternative to
17 that to allow them to recover the costs now, as an
18 encouragement for them to continue proactive monitoring,
19 and then later, once some recovery is actually obtained,
20 to come back and, you know, make sure ratepayers are
21 made whole for those prior payments for the ongoing
22 expenses? Isn't that another alternative?

23 THE WITNESS: That's an alternative, yes.

24 ACALJ NODES: Okay. Thank you.

25 BY MR. SHAPIRO:

1 Q. Just to follow up on that, you have agreed in
2 your testimony that these costs that are being incurred
3 for testing and participation in the legal process
4 benefit ratepayers and are reasonable, right?

5 A. Yes.

6 Q. And we don't know if the company will ever be
7 able to recover any costs from a third party, do we?

8 A. We don't.

9 Q. And do you know what costs can be recovered in a
10 successful Superfund litigation, whether they include
11 testing and legal costs?

12 A. I don't know. I am not an attorney.

13 Q. So even if successful, as far as you know, in a
14 litigation, there is a possibility that the costs that
15 are at issue in this case may not be recovered from a
16 third party, as far as you know?

17 A. But you stated some costs could be recovered.

18 Q. Well, how about the costs of replacement
19 equipment, like new wells, those might be subject to
20 Superfund, right?

21 A. Right.

22 Q. The company is not asking to recover those from
23 ratepayers now, is it?

24 A. No.

25 Q. You would agree with whether Liberty Water pays

1 Mr. Sorensen \$120,000 a year or 110,000 plus a \$10,000
2 performance bonus, the end result is the same salary,
3 right?

4 A. No, because the problem comes on that extra
5 \$10,000. That's not guaranteed.

6 Q. Well, it was paid during the test year, wasn't
7 it?

8 A. But it is a going forward cost.

9 Q. Isn't the test year determinant, isn't the test
10 year presumed to be reflective of the company's expenses
11 on a going forward basis?

12 A. Right. So as Mr. Sorensen stated earlier, the
13 one wastewater operator who was terminated, did he
14 collect his bonus? I don't think so.

15 Q. He didn't collect his salary either, but we
16 didn't come back and adjust for that, did we?

17 A. No. But that's not guaranteed, though.

18 Q. In fact, no operating expense is guaranteed on
19 the utility to remain the same in the future from a test
20 year at all, is it?

21 A. No. But that one is more conditional than most
22 expenses were.

23 Q. In what manner is it more conditional,
24 Mr. Michlik, than, say, the cost of fuel?

25 A. Because the employee has to meet certain

1 objectives in order to get that bonus. He may not,
2 management saying you know what, you didn't do a good
3 job this year, you are not getting any of the \$10,000.

4 Q. But again, the company is not guaranteed that
5 they recover any individual operating cost, correct?

6 A. Correct.

7 Q. It could recover more or less of any particular
8 operating cost?

9 A. And if it recovers less, the company can come in
10 and file another rate case.

11 Q. And the test year -- again, I don't know if we
12 got an answer -- is presumed to be illustrative of the
13 costs the company is going to incur on a going forward
14 basis, correct? That's in the Commission's rules, isn't
15 it?

16 A. Well, except for the parts that are conditional
17 on performance.

18 Q. Well, it is a starting point. It is presumed to
19 be the reflection of the company's costs, and that would
20 make adjustments based on known and measurable changes,
21 right?

22 A. But we don't know if that's a known and
23 measurable change.

24 Q. So you made an adjustment to the cost without
25 having a basis to make it because of a known and

1 measurable change. Is that your testimony?

2 A. No, that the incentive part is conditional and
3 it may not be paid out every year in the future until
4 the next rate case.

5 Q. Did you consider looking at three years of this
6 expense and try to normalize it to capture the
7 possibilities that from one year to the other these
8 amounts may be paid in different sums?

9 A. No.

10 Q. The only basis for your recommendation for
11 five-year amortization of rate case expense is that the
12 company took nine years between rate cases?

13 A. Yes.

14 Q. What about Mr. Sorensen's testimony that that's
15 not the policy of the current owners, to wait that long
16 between rate cases?

17 A. What you say and what you do are two different
18 things.

19 Q. Well, they brought Black Mountain in three years
20 of itself, didn't they?

21 A. Right. Originally we had agreed for four years.
22 Came back in three years. And then Staff said you have
23 a proven track record, and Staff said okay, it is three
24 years. This last case Staff actually gave you
25 normalization expense over three years. You don't come

1 back in nine years, so the company has overearned.

2 Q. Different owner, correct? And the company lost
3 money in the test year, correct? So it didn't overearn
4 anything in the test year, did they?

5 A. Well, that's why you are in for a rate case.

6 Q. And if the company were to come in in three
7 years, then you would agree with Ms. Rowell on behalf of
8 RUCO that the unamortized portion should be added to the
9 rate case expense recovery going forward?

10 A. No.

11 Q. So the company takes Staff's amortization, and
12 either it waits five years to collect it all or it is
13 just out of rate case expense, that's Staff's approach?

14 A. Well, Staff normalized it, so if you came in
15 three years, then yes, you would lose those extra two
16 years.

17 Q. Why is that fair, Mr. Michlik?

18 A. Why is it fair that you overearn these past nine
19 years?

20 Q. Couldn't you just have a surcharge that makes
21 sure the company recovers exactly what the Commission
22 approves, no more, no less?

23 A. I am not aware that we regularly do that in
24 Arizona water and wastewater cases.

25 Q. My question wasn't whether you do it, whether

1 you couldn't. Wouldn't that be a method that would
2 ensure that the problem you are referring to doesn't
3 occur?

4 A. We are not recommending it, though.

5 Q. So you are recommending a situation where the
6 company eventually has to wait five years in order to
7 ensure it recovers rate case expense before it can come
8 in again, correct?

9 A. Yes.

10 Q. And if there is a three-year phase-in and the
11 Commission orders the company back in the end of the
12 phase-in, under those circumstances, too, under Staff's
13 recommendation the company would lose two years of rate
14 case expense recovery?

15 A. You are asking me to speculate on something I am
16 not sure. Could Staff maybe take that into
17 consideration? Maybe. I don't know.

18 Q. Well, I am asking you if the Commission approved
19 a three-year phase in, wouldn't they require the company
20 to come back in at the end of that phase-in as a normal,
21 as a matter of practice?

22 A. I don't know.

23 Q. Have you ever seen a phase-in before?

24 A. Usually a phase-in, your rates are set and after
25 a few years they jump to a higher rate, and after that

1 period of time the company would come back in. So I am
2 not sure what the type of phase-in is being proposed in
3 this case. So maybe if it is a five-year phase-in, then
4 our rate case expense would match it.

5 Q. And how many years is Staff going to propose in
6 its proposed phase-in?

7 A. I don't know.

8 Q. Well, if the company proposes three years and
9 the Commission adopts it, then you would agree with me
10 that a five-year amortization of rate case expense is
11 two years too long, isn't it?

12 A. Yes. But we don't know if that's going to
13 happen or not.

14 Q. You would agree with me that -- well, I am
15 sorry. You were here during Ms. Rowell's testimony?

16 A. Yes.

17 Q. And you are aware that Staff has a different
18 recommendation for the companies in the Global water
19 case?

20 A. Yes.

21 Q. Any explanation of why there is a difference
22 that you are aware of, Mr. Michlik?

23 A. I wasn't the analyst assigned to the case, so I
24 am not sure.

25 MR. SHAPIRO: I am sorry, Your Honor, just a

1 moment.

2 ACALJ NODES: Sure.

3 (Brief pause.)

4 BY MR. SHAPIRO:

5 Q. Just a couple more questions regarding security
6 deposits, Mr. Michlik. First off, did you ascertain
7 whether all the security deposits that the company has
8 came from customers to secure payment?

9 A. I asked in the data request how they came up
10 with their customer deposit on their annual report. And
11 I took those accounts and actually applied them to the
12 test year and came up with my amount.

13 Q. Do you know whether your amount includes
14 security deposits paid by developers?

15 A. They just say customer security deposits, from
16 the lines I pulled out.

17 Q. You would agree with me that a security deposit
18 secures payment by the customer, correct?

19 A. I think it is more of a mechanism where the
20 company, in case the customer disappears, then they have
21 some, they get some type of reimbursement, I guess.

22 Q. Right. So it secures the receivable of the
23 payment for services rendered, correct?

24 A. Correct.

25 Q. Did you include the receivables in your rate

1 base adjustments?

2 A. I just took the amounts from the customer
3 deposits in account 235, I believe.

4 Q. So what the deposit is securing was ignored in
5 the analysis?

6 A. But S-18 applies to all customer deposits.

7 Q. That wasn't my question. My question was not
8 whether or not you accounted for the receivable but what
9 those security deposits are securing.

10 A. No. I took what was listed on the company's
11 spreadsheet as customer deposits.

12 Q. For a meter deposit, the meter is included in
13 rate base, correct?

14 A. No. We took the meter deposit out, customer
15 meter deposit.

16 Q. No, the cost of the meter itself is included,
17 correct? If you know.

18 A. Well, it is refundable to the customer.

19 Q. So is the security deposit, correct?

20 A. Yes.

21 MR. SHAPIRO: Thank you, Mr. Michlik. Nothing
22 further.

23 ACALJ NODES: Any additional questions before we
24 go to redirect?

25 (No response.)

1 ACALJ NODES: Okay. Ms. Mitchell.

2 MS. MITCHELL: Your Honor, you covered pretty
3 much what I was going to cover on redirect, so I don't
4 have any questions for Mr. Michlik.

5 ACALJ NODES: Okay. Very well.

6 Mr. Wiley, any further questions that you need
7 on your issues.

8 MR. WILEY: No, Your Honor.

9 ACALJ NODES: Okay. All right. Mr. Michlik,
10 thank you for your testimony. And you are excused.

11 Let's see. We are going to have Mr. Chaves.

12 MS. MITCHELL: I was going -- let's go get him.
13 Just a minute.

14 ACALJ NODES: Let's just --

15 MS. MITCHELL: I hope he is not passed out at
16 his desk.

17 ACALJ NODES: Let's take a five-minute break and
18 hopefully round Mr. Chaves up.

19 (A recess ensued from 3:01 p.m. to 3:14 p.m.)

20 ACALJ NODES: Okay. We are back on the record.

21 Ms. Mitchell, we are going to recall Mr. Chaves?

22 MS. MITCHELL: Yes, we are. Staff would recall
23 Pedro Chaves.

24 ACALJ NODES: Welcome back, Mr. Chaves. I would
25 remind you you are still under oath.

1 MR. CHAVES: Thank you, Your Honor.

2 ACALJ NODES: And if you will, pull that
3 microphone down just a little bit so you talk directly
4 into it. Thank you.

5 Well, Ms. Mitchell, do you have any additional
6 direct at this point for Mr. Chaves?

7 MS. MITCHELL: Yes, Your Honor. If you would
8 like, I would like to introduce the alternate rate
9 design that you had requested --

10 ACALJ NODES: Okay.

11 MS. MITCHELL: -- when we were last here.

12 ACALJ NODES: All right.

13 MS. MITCHELL: I can't even remember what day
14 that was.

15 ACALJ NODES: Yes, Monday, I think. Okay. Do
16 you -- are you waiting for copies --

17 MS. MITCHELL: Oh.

18 ACALJ NODES: -- or you have it?

19 MS. MITCHELL: Forgive me. Let me pass out
20 copies to the parties. I am staring at them.

21 (Brief pause.)

22 ACALJ NODES: This will be S-21, is that
23 correct?

24 MS. MITCHELL: Yes.

25 ACALJ NODES: Okay.

1 PEDRO CHAVES,
2 called as a witness on behalf of ACC Staff, having been
3 previously duly sworn by the Certified Reporter to speak
4 the truth and nothing but the truth, was further
5 examined and testified as follows:

6

7 DIRECT EXAMINATION CONTINUED

8 BY MS. MITCHELL:

9 Q. Mr. Chaves, in response to a request by Judge
10 Nodes, did you prepare an alternate rate design for this
11 case?

12 A. That is correct.

13 Q. And I put in front of you what I have marked as
14 Staff Exhibit S-21. Could you identify that for the
15 record, please.

16 A. Yes. Exhibit S-21 is the hearing schedule
17 PMC-3, PMC-4, and PMC-5. It provides three-tiered
18 one-inch meter residential rate design.

19 MS. MITCHELL: All right. I would like to move
20 for the admission of Staff Exhibit S-21.

21 ACALJ NODES: Any objection to S-21?

22 (No response.)

23 ACALJ NODES: Okay, S-21 is admitted.

24 (Exhibit S-21 was admitted into evidence.)

25 MS. MITCHELL: And Mr. Chaves is available for

1 cross.

2 ACALJ NODES: Okay.

3

4 FURTHER EXAMINATION

5 BY ACALJ NODES:

6 Q. Since I am the one that asked for this, let me
7 just ask you --

8 A. Your Honor.

9 Q. -- a few questions on what you have done here.
10 It appears that what you did is increased, for the
11 three-quarter inch meters, from 10 to \$12 a month the
12 minimum monthly charge, correct?

13 A. That's correct.

14 Q. And you reduced the one-inch residential minimum
15 monthly charge from 25 to 22.50, correct?

16 A. That's correct.

17 Q. Okay. Now, on the commodity charge, it looks
18 like the only change is that you have, instead of the
19 prior two-tier design, you now have a three-tier design,
20 that the first tier is zero to 4,000 gallons, second
21 tier is 4,001 to 13,000 gallons per month, and the final
22 tier is over 13,000 gallons, correct?

23 A. That's correct, Your Honor.

24 Q. The commodity rates, however, are the same as
25 they are for both five-eighths by three-quarter and

1 three-quarter inch meters, correct?

2 A. That's correct, Your Honor.

3 Q. Okay. Are those the only changes that you made
4 to this alternative rate design, or are there other
5 changes that were made to other customer classes?

6 A. There is one that perhaps I didn't hear you
7 mention, was the five-eighths, three-fourths also was
8 raised to \$12.

9 Q. Oh, okay. Yes, you are correct. And that's a
10 very small group of customers?

11 A. Correct, less than 60.

12 Q. Less than 60. All the commodity rates have
13 stayed the same for every other group of, class of
14 customers except for the one-inch meter, though,
15 correct?

16 A. That's correct, Your Honor.

17 Q. Okay. And how did you -- let me just ask you,
18 how did you determine the breakover points for the
19 one-inch meter in preparing this alternative design?

20 A. Initially I had looked at the nondiscretionary
21 of 3,000, as we typically do. However, we noticed that
22 the average usage, and if you look at the schedule
23 PMC-4, that's the typical bill analysis for the one-inch
24 residential, I show that the average use is much higher
25 than for the three-fourths inch residential. So Staff

1 decided to make that first breakover point a thousand
2 gallons higher.

3 Q. Okay. And is there a thought, when you are
4 designing rates, do you make an attempt to set breakover
5 points at the point at which you believe that some or a
6 number of customers can actually move their usage lower
7 in order to, as a price signal, to move it lower and
8 further conservation efforts by getting into that lower
9 tier of usage and not being charged more, is the theory
10 behind it?

11 A. Yes, Your Honor. If you look at -- yes. The
12 average usage, as I just mentioned, it is 14,556. Staff
13 took that into consideration and that's why we created
14 the second breakover point, the 13,000 gallons.

15 Q. Which is higher than the three-quarter inch
16 meters, which the breakovers are 3 and 19 or 3 and
17 9,000, correct?

18 A. Yes, Your Honor.

19 Q. Okay. But no other customer class is changed in
20 any way by this alternative?

21 A. Not in, you know, besides the changes you have
22 mentioned, correct.

23 ACALJ NODES: Okay. All right.

24 Ms. Wood, do you have questions for Mr. Chaves?

25 MS. WOOD: No, Your Honor, we do not.

1 ACALJ NODES: Thank you.

2 Mr. Shapiro.

3

4 CROSS-EXAMINATION

5 BY MR. SHAPIRO:

6 Q. I guess my first question is: Is Staff
7 substituting this for its prior rate design schedules or
8 is this just offered as an alternative?

9 A. I would say we would be replacing our prior
10 Staff recommendation.

11 Q. And have you done a proof of revenues to
12 determine that this proves out the revenues?

13 A. Correct.

14 Q. You have?

15 A. I have.

16 MR. SHAPIRO: If I could just have a minute,
17 Your Honor.

18 ACALJ NODES: Sure.

19 MS. MITCHELL: I don't want to testify here, but
20 Mr. Chaves, maybe he is under the influence, maybe he is
21 not feeling well, but I don't know if that is truly the
22 Staff position, that we are substituting this one for
23 the -- I don't even know. I don't think we have
24 discussed it, to be honest with you. I mean we prepared
25 this at the direction of Judge Nodes.

1 ACALJ NODES: And you don't, you don't have,
2 Mr. Chaves, you don't have to agree or change your
3 opinion just because I asked for something. I mean --

4 THE WITNESS: Right, and you are right, Your
5 Honor. I guess what I wanted to say is that this serves
6 as an alternative of what Staff had proposed in its
7 surrebuttal testimony, which is our last position. But
8 I thought it was looking forward and saying yes, we did
9 a proof of revenue --

10 ACALJ NODES: Okay.

11 THE WITNESS: -- with this alternative. So in
12 the event that the Commission were to accept Staff's
13 revenue requirement, this rate design would be fit.

14 ACALJ NODES: Okay. So fair to say that the
15 position you had in surrebuttal remains Staff's primary
16 position, however, the alternative would be also
17 acceptable to Staff although it is not your --

18 THE WITNESS: Precisely.

19 ACALJ NODES: -- still not your primary
20 recommendation?

21 THE WITNESS: Yes, Your Honor.

22 ACALJ NODES: Okay.

23 MR. SHAPIRO: And that's fine. Part of the
24 reason, obviously, Mr. Bourassa needs a chance to do a
25 proof of revenue, too. He will try to do that tonight

1 and hopefully Mr. Chaves is right.

2 BY MR. SHAPIRO:

3 Q. All right. Well, let's start off with what
4 would be an easy one. We don't disagree at all over the
5 wastewater design, right?

6 A. That's correct.

7 Q. And we don't disagree over the low income
8 tariff?

9 A. We have not raised any issues with the low
10 income tariff. We sent a data request asking for more
11 information, but we didn't allow any opposition to it.

12 Q. And Staff is aware that the form of low income
13 tariff proposed by LPSCO is materially similar to the
14 low income tariff approved by the Commission last
15 October for Chaparral City Water Company?

16 A. To my understanding they are similar, very
17 similar.

18 Q. Okay. Now, you would agree with me that LPSCO
19 has one customer that buys water on an eight-inch meter,
20 that's Goodyear?

21 A. Yes.

22 Q. And they actually have two eight-inch meters
23 that they buy water under?

24 A. Yes. The bill count that was provided to me
25 reflected two customers at eight-inch.

1 Q. Now, they have other accounts where they buy
2 water, but on the eight-inch meters that's where they
3 buy water for resale on a bulk basis, right?

4 A. I don't know exactly if that's the case. I know
5 that in my bill count they show this eight-inch, two
6 eight-inch customers. And later on, after, you know,
7 looking at the testimony, I know it was the, it was the
8 City of Goodyear who was buying that.

9 Q. And you don't have any reason to disagree with
10 Mr. Sorensen's testimony in this case that Goodyear buys
11 that water and turns around and resells it to their
12 water customers?

13 A. I don't have any reason to disagree.

14 Q. And what is the rate that you are proposing for
15 eight-inch customers?

16 A. Eight-inch customers as a minimum charge or --

17 Q. What will Goodyear be paying for bulk water if
18 your rates are approved, Mr. Chaves?

19 A. There would be a minimum charge for the
20 eight-inch, which is, I believe, \$825.

21 Q. Okay. I am sorry, go ahead.

22 A. And they have a breakover point of 670,000
23 gallons at \$1.88, and then over 670,000 gallons, \$2.88.

24 Q. And did you determine how your proposed rates
25 compare to the rates that Goodyear is paying today for

1 water?

2 A. I did not.

3 Q. Let me -- this is attached to Mr. Bourassa's
4 testimony, but I am going to give you a copy because it
5 might be easier than pulling it all out.

6 A. Thank you.

7 Q. This is Exhibit TJB-RJ3 to Mr. Bourassa's
8 rejoinder.

9 A. You say it is TJB?

10 Q. RJ3.

11 Judge, I am happy to mark it if you want. It is
12 already in evidence. I was just using it so everybody
13 didn't have to dig out Mr. Bourassa's testimony again.

14 ACALJ NODES: Let's go ahead and mark it. I
15 think this would be 37.

16 BY MR. SHAPIRO:

17 Q. Now, Mr. Bourassa in this -- well, let me
18 rephrase that.

19 Based on the Exhibit 37, can you tell me what
20 return the company will realize from sales to the
21 eight-inch customers under your recommended rates?

22 A. Per this schedule would be 202.79 percent.

23 Q. Do you have any basis to disagree with the
24 conclusions in Mr. Bourassa's schedule here?

25 A. You know, I have looked at the rejoinder. I

1 haven't looked at the work paper itself, but, you know,
2 I don't have any reason to.

3 Q. You will accept these numbers subject to check?

4 A. If you check them. No, I mean what I mean is I
5 don't know if I have the time to go back and look at
6 this schedule and then argue, you know, no, I want to
7 retract my testimony and disagree with that. So it
8 seems that's what the schedule portrays here.

9 Q. Okay. What is Staff's recommended weighted
10 average cost of capital in this case?

11 A. If you tell me, I might take that subject to
12 check.

13 Q. 8.7. You will take that subject to check?

14 A. Yes. That sounds like a number Mr. Manrique had
15 calculated.

16 Q. Okay. Mr. Chaves, why is it in the public
17 interest to have LPSCO earn a return over 200 percent
18 selling water to a city for resale to the city's
19 customers?

20 A. Can you repeat the question, please.

21 Q. Yes. Why is it in the public interest to have
22 LPSCO earn a return of over 200 percent selling water to
23 a city for resale to the city's customers?

24 A. Again, as I responded to you, I took that
25 information, it is selling it to city customers. I have

1 not performed an analysis on that either. Or, you know,
2 as you ask it, an analysis should probably be done to
3 respond to that question maybe, or maybe I am just
4 reading the question wrong.

5 Q. Well, I can ask it this way. Why is it
6 appropriate to have LPSCO earn a return of over
7 200 percent selling water to a city for resale to the
8 city's customers?

9 A. Okay. Looking under the perspective of the rate
10 design, I was looking at two customers of eight-inch
11 customers, right, that serve, that were customers the
12 company that -- well, see, if Litchfield Park has the
13 eight-inch meter --

14 Q. Well, it is Goodyear that has the --

15 A. I am sorry, the City of Goodyear. I apologize.

16 Q. That's okay.

17 A. The rate design that was present in the last
18 rate case that, I believe it was a settlement agreement,
19 had a similar distribution to an eight-inch where the
20 City of Goodyear classified on, if my recollection is
21 correct. So we didn't vary that much from the rates
22 that were accepted in the prior rate case.

23 Now, I would have to take a look at some data,
24 but we did not perform a study that went back and looked
25 at who the water was being sold to at the end, meaning,

1 you know, City of Goodyear to the city customers
2 themselves. And I don't know how much they are charging
3 for water, so I really don't know if I could answer that
4 question correctly.

5 ACALJ NODES: Mr. Chaves, could it be the case
6 that the City of Goodyear, in which a number of LPSCO's
7 customers reside, would have an interest in not seeing
8 residents of its city incur even greater rate increases
9 from LPSCO to the point that the differential between
10 the City of Goodyear's rates and LPSCO's rates would be
11 perhaps a significant amount? The city could be looking
12 at it from the perspective of representing all of its
13 own residents, whether they reside -- whether they are
14 served by LPSCO or City of Goodyear, could they not?

15 THE WITNESS: Yes, that very well could be.

16 ACALJ NODES: And if the water that is provided
17 to Goodyear through the eight-inch mains is decreased,
18 if the amount of revenues from that customer decreased,
19 then they have to be picked up from somewhere else, and
20 it could be placing the burden back on the LPSCO-served
21 Goodyear residents, correct?

22 THE WITNESS: Again, it could be. But as you
23 say, there is many different things that could happen.

24 ACALJ NODES: Well, the revenues have to be
25 collected from someone?

1 THE WITNESS: Yes.

2 ACALJ NODES: So to the extent that they are, if
3 the revenues are reduced from the eight-inch customer,
4 Goodyear, they would have to be then recovered from some
5 other customers, including City of Goodyear residents
6 who happen to be served by LPSCO, correct?

7 THE WITNESS: That's correct.

8 ACALJ NODES: So those City of Goodyear
9 residents could indeed be very unhappy if Goodyear
10 sought to reduce the rates that it pays to LPSCO for
11 that water served for the eight-inch mains, correct?

12 THE WITNESS: That's correct.

13 ACALJ NODES: All right.

14 BY MR. SHAPIRO:

15 Q. Well, Mr. Chaves, in agreeing with Judge Nodes
16 are you suggesting that the City of Goodyear is willing
17 to pay a higher bulk rate to keep the rates to the
18 citizens down, is that my understanding of your
19 testimony?

20 A. No. What was said is that if the rates from the
21 eight-inch were to be reduced, perhaps some of those
22 customers that the city has might have a bigger bill
23 impact than what they would have otherwise.

24 Q. Well, Mr. Sorensen testified in this case that
25 if a rate as high as Staff's is adopted for Goodyear,

1 Goodyear is going to leave the system. Do you recall
2 that?

3 A. I believe I recall him testifying to that.

4 Q. And if Goodyear leaves the system, the same
5 thing is going to happen, isn't it, those revenues over
6 \$800,000 in your rate design are going to have to come
7 from all the other customers, right?

8 A. Well, if my memory serves me correctly, the City
9 of Goodyear, if -- you know, there is a couple ifs. It
10 might just leave by itself, right, if there is another,
11 another deal for them going on around. So yes, if the
12 city leaves, yes, that may happen.

13 Q. And if the city leaves, the company is going to
14 have a \$900,000 revenue shortfall roughly right off the
15 bat, right?

16 A. If that's the case, yes.

17 Q. And the company, if the company comes back in
18 for rates, you are not going to have the eight-inch
19 meter customer to put \$900,000 of revenue to, right?

20 A. All other things remaining equal, yes, unless
21 there is maybe another eight-inch client that appears.

22 Q. And if we have to spread \$900,000 of revenue
23 that once went to Goodyear, are you going to spread that
24 over just the commercial customers?

25 A. No.

1 Q. So isn't there an incentive to keep Goodyear on
2 the system as a bulk customer?

3 A. Again, you may think that that's an incentive,
4 but they might just leave the system, as the testimony
5 of Mr. Sorensen indicates.

6 Q. Well, the City of Goodyear buys water now from
7 LPSCO because it is cheaper to buy it from LPSCO than it
8 is to pump their own, right? That's Mr. Sorensen's
9 testimony?

10 A. That is his testimony.

11 Q. So if the rate goes up, then it makes it more
12 likely that it would be cheaper to pump their own,
13 right?

14 A. Right. I do not know how much it costs them to
15 pump their own water, though. That's the nature of my
16 response. That's why I can't say.

17 Q. Okay. And I mean this is a time when cities
18 have some municipal budget issues. It might be a burden
19 on the city to have its water rates increased or its
20 costs of producing water increased?

21 A. I don't know the city's budget situation.

22 Q. Okay. Referring back to what is now Exhibit 37,
23 how is it appropriate that 95 percent of LPSCO's
24 customers are going to pay rates that are below the cost
25 of service?

1 A. And that's TJB-RJ3?

2 Q. Yes, also Exhibit A-37. It has multiple names.

3 If it helps, Mr. Chaves, I can certainly break
4 that down if I confused you. Would that be more
5 helpful?

6 A. You mean --

7 Q. Let me tell you where I got those numbers from.
8 You would agree with me that part of a utility's cost of
9 service is its return, right?

10 A. That's a portion.

11 Q. Okay. And you would agree with me looking at
12 this exhibit that approximately 95 percent of LPSCO's
13 customers fall into the five-eighths by three-quarter,
14 three-quarter, or one-inch meter size, right?

15 A. Roughly, yes.

16 Q. Okay. And you would agree with me that
17 three-quarter inch customers would be paying a cost of
18 service that includes a return that is approximately 600
19 basis points below Staff's recommended return, right? I
20 am sorry, that's the three-quarter. If I said
21 five-eighths, I apologize.

22 A. Okay.

23 Q. That's 2.3 percent compared to 8.7?

24 A. Right.

25 Q. And then the one-inch, which is the other

1 predominant group of the company's residential
2 customers, correct?

3 A. Yes.

4 Q. They are paying a return that includes -- I am
5 sorry. They are paying rates that include a return
6 that's roughly 200 basis points less than the Staff's
7 authorized return, right?

8 A. Yes. That's what the schedule says.

9 Q. So I guess again back to my question, how is it
10 appropriate to have so many of the company's customers
11 paying a return that is below the authorized rate of
12 return that Staff is recommending?

13 A. Well, I mean there is factors that you have to
14 include. Like, for example, the five-eighths, the
15 three-fourths, the one-inch, they have different
16 capacities, right? So I am just looking at the
17 schedule. I am thinking, well, some -- the more
18 capacity you have, the more you are demanding on the
19 system, and so on and so forth.

20 Q. Well, wouldn't -- are you suggesting that the
21 reason that the residential customers are paying lower
22 returns is cost of service?

23 A. No, I am not arguing that.

24 Q. Okay. Do you have an explanation as to why it
25 is appropriate for the three residential groups to pay

1 returns that are significantly lower than Staff's
2 authorized overall rate of return?

3 A. Well, I wish I could overview this information
4 longer. I will have to take a look at Schedule G-4,
5 page 1, rejoinder also, just because I notice that the
6 amortization, the amortization and amortization numbers
7 also, you know, are quite considerable. I mean the,
8 also, operating expenses depreciation computation for
9 showing G-4, page 1, I reviewed those in a short period
10 of time before, you know.

11 Q. Let me ask this question then, Mr. Chaves. Do
12 you agree that under Staff's rate design the residential
13 customers are going to pay a cost of service that
14 includes a return that is lower than Staff's authorized,
15 recommended authorized return?

16 A. That's what this schedule seems to indicate.

17 Q. Okay. And as you sit here today, you don't have
18 an explanation as to why that's appropriate, is that
19 your testimony?

20 A. Well, again, I have to take a look at the
21 calculations and so on and so forth to be able to
22 determine that this is actually the return and something
23 that would be comparable to a cost of capital that
24 Mr. Manrique calculated.

25 Q. Okay. Can you tell me the goal of Staff's rate

1 design?

2 A. Fair and reasonable rates.

3 Q. And in your testimony, it is fair and reasonable
4 for a four-inch customer to pay a cost of service that
5 provides a 31 percent return, and a three-quarter inch
6 customer to provide a return of less than two and a
7 half percent, that's fair and reasonable?

8 A. Yes.

9 ACALJ NODES: And Mr. Chaves, is one of the
10 goals that Staff seeks to achieve is trying to mitigate
11 to the extent possible the rate shock or the rate
12 increase impact on residential customers especially?

13 THE WITNESS: Well, Staff is concerned with the
14 rate impact on customers. And again, it is one of those
15 factors that we take into account, like efficient use of
16 water and so on.

17 ACALJ NODES: And is it fairly typical in your
18 experience for the residential class of customers,
19 regardless of meter size, to have a revenue
20 responsibility that is often less than the return that's
21 achieved for the other nonresidential classes of
22 customers?

23 THE WITNESS: Yes, Your Honor. That's what I am
24 seeing in multiple prior Staff reports and Commission
25 adopted rate designs.

1 ACALJ NODES: Okay. Thanks.

2 BY MR. SHAPIRO:

3 Q. Mr. Chaves, how did Staff address the concept of
4 rate shock in its rate design?

5 A. Again, that's when I was asked by our attorney,
6 if Staff's --

7 Q. Let me stop you, Mr. Chaves, because I don't
8 want you to tell me anything that your attorney told
9 you, or she told you.

10 A. As she directed in the testimony in the
11 beginning.

12 Q. Okay.

13 A. When she mentioned that regarding rate shock, I
14 mentioned that Staff is concerned with the rate impact
15 that rates are going to put like residential customers
16 and, you know, other customers on. If you look at my
17 Schedule, my hearing Schedule PMC, you can look at
18 PMC-5, it is the last one on the one that we distributed
19 today, if you look at the percentage increase of Staff's
20 recommended rates, at no usage, for example, it is
21 44.58 percent, whereas the company's is 128 percent.
22 For 2,000 gallons, the company proposes 127 percent
23 increase, a little bit over. And Staff recommends
24 39 percent.

25 Q. But that has to do a lot with the different

1 level of revenue that's being recommended, too, isn't
2 it?

3 A. It does --

4 Q. Okay.

5 A. -- yes.

6 Q. And what did Staff do to consider -- well, let
7 me strike that.

8 Is there such a thing as rate shock to
9 commercial customers?

10 A. Again, each individual customer has a perception
11 of what rate shock would be. But they do have billing
12 practice as well, yes.

13 Q. Well, did you do anything to -- it sounds like
14 you took steps to ameliorate the impact of the rate
15 increases on residential customers through your rate
16 design, correct?

17 A. I think the rate design itself, being like
18 inverted three-tier for residential and like a two-tier
19 for commercial, actually, you know, one promotes
20 efficient usage of water and it produces reasonable
21 rates for both the commercial and the residential.

22 Q. But you agree with me that revenue has shifted
23 from recovery by residential customers to customers with
24 larger meters under your rate design, right?

25 A. By revenue shifting, can you --

1 Q. Isn't that how we get the levels of return, the
2 higher meters paying above the authorized level of
3 return and the lower meters paying below, doesn't that
4 come from a revenue shift?

5 A. I just want to see what definition you had for
6 revenue shift.

7 Q. I guess that would be it.

8 A. Okay. You could say that.

9 MR. SHAPIRO: Thank you, Mr. Chaves. We hope
10 you feel better.

11 ACALJ NODES: Okay.

12 THE WITNESS: Thanks.

13 ACALJ NODES: Mr. Udall.

14 MR. UDALL: Thank you, Your Honor.

15 ACALJ NODES: Yes. Can you get the microphone.

16 MR. SHAPIRO: I am sorry, Your Honor, I didn't
17 move A-37.

18 ACALJ NODES: All right. Any objection to A-37?

19 (No response.)

20 ACALJ NODES: All right, it is admitted.

21 (Exhibit A-37 was admitted into evidence.)

22

23 CROSS-EXAMINATION

24 BY MR. UDALL:

25 Q. Good afternoon, Mr. Chaves.

1 A. Good afternoon.

2 Q. Mr. Chaves, would you agree with me that a
3 residential customer's usage of water is not consistent
4 over a 12-month period?

5 And let me illustrate. I am not trying -- there
6 is no trick aspect to this. Fair to conclude that a
7 typical residential customer is going to be using more
8 water in the summer when they might be watering their
9 flowers and garden and little plot of grass; they might
10 be using less water in the winter, less needs for
11 bathing, they are not out sweating as much? Fair
12 assumption?

13 MR. SHAPIRO: We just want to say for the record
14 we don't agree with Mr. Udall's characterization of our
15 customer base. They are the best people in the world.

16 BY MR. UDALL:

17 Q. Go ahead.

18 A. Right, they are, as you mentioned, yes, there is
19 some variability of use depending on weather and so on,
20 yes.

21 Q. Okay. Now, with that as some groundwork, I want
22 to direct your attention to Exhibit S-21, where you have
23 the rates for the five-eighths and three-quarter meter
24 and for the three-quarter meters. And you will note
25 that there is a break, the highest category breaks at

1 9,000 gallons. Do you see that?

2 A. I see that.

3 Q. And would you agree with me that if -- well,
4 first of all, the average for a 9,000 gallon annual
5 usage, if the usage were consistently average, it would
6 be 750 gallons per month. Do you understand? If I take
7 9,000 gallons, which is an annual usage -- correct?

8 A. Approximately.

9 Q. Okay. And if you divide that by 12 for a
10 monthly usage, then the monthly usage, if usage were
11 consistent, would be 750 gallons. Do you follow my
12 line, my reasoning there?

13 A. I believe I don't.

14 Q. Per month. Okay. Well, if a customer is using
15 750 gallons per month, then his annual usage would be
16 approximately 9,000 gallons per year?

17 A. Right.

18 Q. Okay. But if the customer --

19 ACALJ NODES: Wait a minute, wait a minute. I
20 think the 9,000 gallons is a monthly average, not a
21 yearly average.

22 THE WITNESS: That's correct.

23 ACALJ NODES: Yes. 750 gallons a month would be
24 difficult to survive on, I would posit, especially for
25 LPSCO's Litchfield Park customers.

1 BY MR. UDALL:

2 Q. Let me ask you this, Mr. Chaves. Where does
3 this 9,000 gallon figure come from for a break in your
4 tariff where there is a significant jump? Is that an
5 arbitrary figure that someone came up with, or is it the
6 basis of --

7 A. You mean the 9,000, the 9,000 breakover, second
8 breakover for the three-fourths is the one you are
9 mentioning?

10 Q. Yes.

11 A. Okay.

12 Q. How was that figure arrived at?

13 A. Okay. Similar to the line of questioning of
14 Judge Nodes, when we looked at the average usage four to
15 three-fourths, we noticed that their gallon usage was
16 9,537.

17 When you look at schedule S-21, PMC-5, that's
18 the typical bill analysis, that in our mind somehow
19 promotes efficient water, use of water, because it is --
20 the customers would be able to achieve that 9,000
21 gallons, if they are so close to 9,000 gallons already.
22 So they are using 9,537, they might be able to see, hey,
23 if we use 500 less, we might be at a lower rate.

24 Q. Okay. And that figure, that figure, I believe
25 you also have it on Schedule PMC-2W attached to your

1 direct testimony, you have a figure of average usage for
2 9,537 gallons?

3 A. That's correct.

4 Q. Okay. So let's say hypothetically that a person
5 is able to achieve that on an annual basis, but on a
6 monthly basis, let's say for the summer months,
7 approximately six or eight months, the warmer months of
8 the year, they might be slightly above that and they
9 will be cast for those six, maybe nine months in the
10 higher bracket, but where they cut back considerably in
11 the winter and achieve substantial savings, they have
12 met that as an average yearly, but for the bulk of the
13 year they are cast into a higher, into a higher rate.
14 Is that something that the Staff took into
15 consideration?

16 A. Well, yes. And, you know, whenever they exceed
17 the 9,000, they will be getting a higher rate. And
18 that, perhaps it is the line of thinking that sends that
19 signal to the customer to say, hey, let's be cautious
20 about the use of water; if I don't see the 9,000, we
21 won't be getting into that higher tier.

22 Q. Okay. Mr. Chaves, do you know what percentage
23 of the residents of Litchfield Park will be cast into
24 this higher rate, the highest rate over 9,000?

25 A. I cannot tell. You know, with some data I might

1 be able to calculate that.

2 Q. Let me throw something out. Let's just say
3 hypothetically, and I believe these figures are derived
4 from information supplied by the company, it is our
5 understanding that there are approximately 107,000
6 customers, 107,000 bills that are generated on a monthly
7 basis. And -- sorry, annually. And approximately
8 65 percent of those annually generated bills are over
9 this average figure of 9500 gallons per month.

10 So based on that, would you agree with me that
11 the bulk of the residents of Litchfield Park are going
12 to be cast into the highest tier and paying the highest
13 rate? Is that something that the Commission -- are
14 those specific facts something that the Commission took
15 into consideration?

16 MR. SHAPIRO: Let me just interpose, I guess, a
17 request for some clarification. I am trying to figure
18 out how 16,000 customers receiving bills every month
19 only generates 107,000 bills. I think there is some
20 definite math wrong, and since it was represented that
21 the company provided it --

22 ACALJ NODES: And are you talking about just the
23 City of Litchfield Park perhaps?

24 MR. SHAPIRO: Okay, okay.

25 ACALJ NODES: Okay.

1 MR. UDALL: Does that make sense?

2 MR. SHAPIRO: Yes. I thought he was talking
3 about the entire billing for the entire company.

4 MR. UDALL: I thought -- I am sorry.

5 ACALJ NODES: Okay. Litchfield Park customers
6 only. And I don't know that your question is
7 necessarily that you have to have a number. It sounds
8 like that you are asking him to assume that 65 percent
9 of the customers use over that amount and did Staff take
10 that into account when developing its rate design.

11 MR. UDALL: That is correct, Your Honor.

12 ACALJ NODES: Okay.

13 MR. SHAPIRO: Thank you, Judge Nodes.

14 THE WITNESS: Yes. And again, as I recall when
15 you questioned, it was a hypothetical question. So, you
16 know, in that case, you know, we do look at the average.
17 We do look at the median for purposes of a typical bill
18 analysis. And we include all the other, you know, all
19 the billing determinants that are provided to us, which
20 means all the bills. We do not look at those like
21 individually, if you may. I mean we are looking at a
22 lot of bills, and we look at the average, we look at the
23 median, and we try to do the best with what we have.

24 MR. UDALL: Okay. Thank you.

25 No further questions, Your Honor.

1 FURTHER EXAMINATION

2 BY ACALJ NODES:

3 Q. Just one follow-up.

4 Mr. Chaves, is it your understanding that
5 Staff's goal, and as you understand it from reading
6 Commission orders and listening to the Commissioners
7 during open meetings, the goal is to have higher usage
8 customers pay more for the commodity, the water, as a
9 means of sending a signal to those higher usage
10 customers that water is a valuable commodity and that it
11 should be used wisely?

12 A. Definitely, Your Honor, yes.

13 Q. And that's the goal in general terms of the
14 inverted tier rate design, to have the higher use
15 customers, the cost causers essentially, be responsible
16 for a higher amount so as to encourage conservation?

17 A. Yes, Your Honor.

18 ACALJ NODES: Okay. Thank you.

19 Before we go to redirect, Mr. Shapiro, do you
20 have any further questions?

21 MR. SHAPIRO: Yes.

22

23 FURTHER CROSS-EXAMINATION

24 BY MR. SHAPIRO:

25 Q. The company's rate design contains a similar

1 inverted block approach that makes higher users pay more
2 for water at the higher levels, correct?

3 A. That is correct, although I have mentioned my
4 concern with the crossover points at three-fourths inch
5 meter and one-inch meter.

6 Q. But it is an inverted block rate design that is
7 in and of itself the kind of rate design that promotes,
8 is intended to promote conservation?

9 A. Yes. However, I mean, you know, one-inch are
10 going to pay less than three-fourths inch for the same
11 amount, so they may have issues with that.

12 Q. Part of the process of developing a rate design
13 is balancing the different factors that go into
14 determining where breakover points should be, commodity
15 versus fixed rates, et cetera?

16 A. Yes.

17 Q. One of the factors that you consider is cost of
18 service --

19 A. Yeah.

20 Q. -- and impact on customers, those are other
21 factors that you consider in that balancing act?

22 A. Correct.

23 MR. SHAPIRO: Thank you.

24 ACALJ NODES: Okay. Ms. Wood, did you have any
25 questions?

1 MS. WOOD: Just briefly.

2

3

CROSS-EXAMINATION

4 BY MS. WOOD:

5 Q. It is not uncommon, is it, for municipalities in
6 some fashion to subsidize the cost of water and sewer
7 for their customers to avoid impact or large impact, or
8 the impact of large increases, is it?

9 A. I have seen that in the past, yes.

10 Q. Okay. And for commercial customers who may have
11 a large increase as a result of this rate application,
12 they at least have the option of passing on some portion
13 of that cost to their customers, correct?

14 A. Correct.

15 Q. Okay. And residential ratepayers do not have
16 that latitude, correct?

17 A. They do not.

18 MS. WOOD: Thank you.

19 ACALJ NODES: Did you want --

20 MR. SHAPIRO: I guess I would ask on what basis
21 Mr. Chaves is qualified to testify regarding
22 municipalities' rate designs.

23 THE WITNESS: Is that a question to me?

24

25

1 FURTHER CROSS-EXAMINATION

2 BY MR. SHAPIRO:

3 Q. As long as I am allowed to ask it it is.

4 A. Well, I have reviewed, you know, different
5 reports that may not be exactly related to this, but,
6 you know, throughout the course of my work as a public
7 utilities analyst I have encountered several cases where
8 I have noticed some subsidization. An example would be
9 SRP, that it is an agricultural and improvement district
10 that subsidizes its water.

11 Q. You are not aware of any evidence in this record
12 of any willingness by the cities of Litchfield Park or
13 Goodyear to subsidize their citizenry, are you?

14 A. Not to my knowledge.

15 MR. SHAPIRO: Thank you, Mr. Chaves.

16 ACALJ NODES: Okay. All right.

17 Mr. Udall, anything further before we go to
18 redirect?

19 MR. UDALL: No, Your Honor.

20 ACALJ NODES: Okay. Redirect, Ms. Mitchell?

21 MS. MITCHELL: Thank you, Judge Nodes.

22

23 REDIRECT EXAMINATION

24 BY MS. MITCHELL:

25 Q. Mr. Chaves, do tiered rates provide a customer

1 with the ability to control their bill?

2 A. It provides them the opportunity, yes.

3 MS. MITCHELL: That's all I have. Thank you.

4 ACALJ NODES: All right. Anything further?

5 (No response.)

6 ACALJ NODES: Okay. Thank you, Mr. Chaves.

7 THE WITNESS: Thank you, Your Honor.

8 ACALJ NODES: You are excused.

9 Okay. Now, Mr. Wiley, the company wants to
10 first put on Mr. Jones?

11 MR. WILEY: Yes, sir.

12 ACALJ NODES: And then the thought is Mr. Jones
13 would do his direct and then come back tomorrow morning
14 for cross-examination?

15 MR. WILEY: If that's the judge's preference,
16 yes. I will tell you that Mr. Jones' testimony will
17 probably only last 20 minutes.

18 ACALJ NODES: Okay.

19 MR. WILEY: So we will have time for
20 cross-examination time.

21 ACALJ NODES: Well, right. But my thought is in
22 order to afford, I think it will only be RUCO probably
23 with cross, but to offer them more time to prepare, I
24 think that would be preferable, and then we will come
25 back tomorrow with Mr. Jones for cross as long as he is

1 available.

2 MR. WILEY: That's fine, Your Honor. Mr. Jones
3 is available in the morning for cross-examination.

4 ACALJ NODES: Okay. Ms. Wood.

5 MS. WOOD: We lay forward our same objections
6 and we still object. You can -- you have already made
7 your decision.

8 ACALJ NODES: You know, I take it from your
9 prior comments that you think I am giving the company
10 preferential treatment, which I really don't understand
11 the concept. Let me just ask you this. Didn't you lead
12 each of your witnesses through direct examination
13 responding to prior testimony that came during the
14 hearing prior to their appearance?

15 MS. WOOD: Your Honor, I don't wish to belabor
16 the point. RUCO has a very firm position. The
17 procedural order says all witnesses will prefile
18 testimony and we will all have the opportunity to at
19 least have a first look. We did not have a first look
20 at anything that Mr. Jones is proffering up, as far as
21 we know.

22 You also indicated that you would listen to his
23 testimony and then make a decision. We are living with
24 that decision right now. That's what you have decided.
25 And we laid -- we incorporate by reference our prior

1 arguments, and we will just see where it goes after
2 this.

3 ACALJ NODES: Well, no, my question, though, to
4 you is: Have you seen that I have permitted direct
5 examination to be taken of each of the witnesses to
6 respond to prior testimony given during the hearing,
7 including for all of your witnesses?

8 MS. WOOD: Each of our witnesses prefiled
9 testimony. And each of the witnesses that we
10 cross-examined filed prefiled testimony. And yes, we
11 did cross-examine them with the information we had
12 available to us, yes.

13 ACALJ NODES: No. You were permitted to do
14 direct examination of your own witnesses on the stand
15 regarding testimony by company witnesses to which they
16 would not have had an opportunity to respond prior to
17 appearing on the stand, correct?

18 MS. WOOD: Well, with all due respect, Your
19 Honor, the direct testimony that we elicit from our
20 witnesses is in direct response to prefiled rejoinder
21 testimony, to which we don't otherwise have an
22 opportunity to respond without doing it on direct. And
23 that's what we typically do.

24 ACALJ NODES: So it is -- you didn't ask your
25 witnesses any questions about prior testimony that was

1 given orally during the hearing?

2 MS. WOOD: I am not sure what your question -- I
3 asked all of my witnesses, I think, some questions
4 relating to issues that have been brought up in
5 rejoinder to which we had not previously known about or
6 had an opportunity to respond, yes.

7 ACALJ NODES: Okay. And so to that extent, the
8 oral testimony that your witnesses gave could not have
9 been heard or known before your witness appeared and
10 gave that direct testimony, correct, orally on the
11 stand?

12 MS. WOOD: Since the issues upon which they
13 provided testimony were related back directly to
14 rejoinder testimony, the issues were not a surprise. We
15 do not have any idea what Mr. Jones is going to testify
16 about. We will wait and see. And we will -- we have
17 made our arguments. And I feel like you are in a
18 position in a ruling and I am not going to persuade you
19 to a different point. And I have a position that I have
20 laid out, and I retain that position for the purposes of
21 appeal and nothing else. So I understand that you have
22 made your decision.

23 ACALJ NODES: Okay. All right. Mr. Wiley, do
24 you want to call Mr. Jones?

25 MR. WILEY: Yes, we would ask Mr. Ray Jones to

1 take the stand, Your Honor.

2

3 RAY JONES,

4 called as a rebuttal witness on behalf of the Applicant,
5 having been first duly sworn by the Certified Reporter
6 to speak the truth and nothing but the truth, was
7 examined and testified as follows:

8

9 DIRECT EXAMINATION

10 BY MR. WILEY:

11 Q. Good afternoon, Mr. Jones. Could you please
12 state your name for the record and your business
13 address.

14 A. My name is Ray Jones. My business address is
15 25213 North 49th Drive. That's Phoenix, Arizona 85083.

16 Q. On whose behalf are you testifying in this
17 proceeding?

18 A. I am testifying on behalf of Litchfield Park
19 Service Company.

20 Q. And who is your current employer and what do you
21 do?

22 A. I am self-employed at my consulting firm, Aricor
23 Water Solutions. I provide a variety of services to
24 municipal and regulated utility and developer clients.
25 A big part of my services are related to cases before

1 the Arizona Corporation Commission.

2 Q. And what is your professional, or your
3 educational background and professional qualifications?

4 A. My educational background began with a bachelor
5 of science degree in civil engineering from the
6 University of Kansas. I later received a master's of
7 business administration degree from Arizona State
8 University.

9 In terms of professional qualifications, I have
10 been employed in the utility industry for nearly 20
11 years, most of that time with Citizens Utilities
12 Company, later known as Citizens Communications Company,
13 associated with their water and wastewater operations
14 here in the State of Arizona. Began there as a staff
15 civil engineer, progressed through the manager for the
16 engineering development services department, and was
17 ultimately the vice president and general manager for
18 the Arizona operations of Citizens.

19 At some point we were, or at least the assets of
20 the company were acquired by American Water, or
21 specifically I guess Arizona-American Water Company.
22 And at that time, I went, became employed by
23 Arizona-American Water and was the president of that
24 company.

25 I also have professional engineering licenses in

1 Arizona and California, and am a Grade 3 operator in all
2 four operative classifications in the State of Arizona.

3 Q. Now, what has been marked up on the witness
4 stand as Exhibit A-38 is a copy of your resumé, correct?

5 A. Yes, it is.

6 Q. Is that a true and correct and accurate copy of
7 your current resumé?

8 A. Yes, it is.

9 MR. WILEY: Judge, I would move in A-38.

10 ACALJ NODES: Okay. Any objection to A-38?

11 (No response.)

12 ACALJ NODES: All right. A-38 is admitted.

13 (Exhibit A-38 was admitted into evidence.)

14 BY MR. WILEY:

15 Q. Have you previously testified before the Arizona
16 Corporation Commission before?

17 A. Yes, I have, on numerous occasions, CC&Ns, rate
18 cases, tariff filings, approval of acquisition, a number
19 of different topics which are detailed on Exhibit A-38,
20 yes.

21 Q. So, in other words, do the second and third
22 pages of your resumé which is marked as Exhibit A-38
23 delineate various cases in which you have testified
24 before the Commission or before administrative law
25 judges presiding over Commission proceedings?

1 A. Yes, that's correct.

2 Q. Okay. Now, you understand that you have been
3 called as a witness in LPSCO's rebuttal case in this
4 currently pending rate case, correct?

5 A. Yes, that's my understanding.

6 Q. Okay. What is the purpose of your rebuttal
7 testimony here today?

8 A. Well, I am responding to the oral hearing
9 testimony of RUCO's witness Mr. Matt Rowell, where in
10 the hearing he testified that it would be inappropriate
11 to include the cost of certain upgrades at the Palm
12 Valley wastewater reclamation plant in the rate base for
13 the company, at least not fully include those.

14 And more specifically, it is my understanding
15 that he testified that due to the magnitude and nature
16 of those upgrades, that the full cost, it would be
17 inappropriate and unfair to include the full cost of
18 those upgrades in the rate base of the company.

19 Q. In his testimony did it also include opinions
20 regarding the timing of those upgrades in relation to
21 the original construction of the Palm Valley plant?

22 A. Yes. I believe part of his point was that they
23 had occurred over a relatively short period of time from
24 the initial construction. And I believe that was part
25 of his reasoning behind his recommendation.

1 Q. Do you agree with Mr. Rowell's conclusions in
2 his testimony?

3 A. I do not. I do not find it, I guess, generally
4 that it is unusual for a wastewater treatment plant to
5 need upgrades shortly or in a relatively short period of
6 time after construction of the plant, particularly in
7 the case of a rapid growth environment, which is, of
8 course, the environment that Litchfield Park Service
9 Company was in during this time.

10 And I guess likewise, looking at the specific
11 case here, I don't find anything unusual or exceptional
12 with regard to the upgrades that were performed that
13 would warrant not including those in the rate base.

14 Q. In your opinion, Mr. Jones, would it be unfair
15 to LPSCO's ratepayers to include the cost of the 2007,
16 2008 upgrades, which is \$7 million, in LPSCO's rate base
17 in this case?

18 A. No, I don't think that would be unfair. In
19 reaching that conclusion, I would just say that in order
20 to prepare, I looked at the prefiled testimonies of
21 Mr. Sorensen, of Mr. Rowell, of Mr. McBride. I listened
22 to Mr. Rowell's oral testimony on Monday. I listened to
23 Mr. Scott's testimony today, which addressed some of the
24 same issues. I also reviewed the, I think it is
25 referred to as a strategic evaluation that Mr. McBride

1 prepared. And I reviewed the original design report for
2 the facility. I also recall reading a Staff report that
3 was dated sometime in 2007 that seemed to be focused
4 more on the schedule and timing, you know, of the
5 improvements, that this was done before they had
6 actually been constructed.

7 And based on, you know, the review of all of
8 those, that documentation, again, I guess probably to
9 restate, I think these improvements are not unusual.
10 They are not, certainly not of excessive cost. I think
11 that point was made clear in the record. And I believe
12 it would be appropriate to include them in the rate
13 base.

14 I guess I would also note that they were -- it
15 was clear that the plant was properly permitted. The
16 appropriate regulatory agencies, Department of
17 Environmental Quality and the Maricopa County
18 Environmental Services Department, reviewed those design
19 reports, plans, specifications, issued the appropriate
20 permits, inspected the facilities when they were
21 complete, and issued the permits properly for the
22 facility.

23 So given all of that, I don't believe it is
24 unfair to include the cost of that plant upgrade, as
25 well, I guess, as the cost of the entire plant, which I

1 understand has never been placed into the rate base for
2 recovery from the customers.

3 Q. In preparing for your testimony today,
4 Mr. Jones, did you review the transcript from
5 Mr. McBride's testimony that he gave on Tuesday of last
6 week during this rate case hearing?

7 A. I reviewed the portion of it pertaining to this
8 issue.

9 Q. You reviewed the portion pertaining to
10 Mr. McBride's testimony, correct?

11 A. Yes, that's what I meant. I didn't review the
12 entire transcript for the day. I reviewed all of
13 Mr. McBride's testimony, that's right.

14 Q. Based upon your 20 plus years of experience as
15 an engineer and as a utility operator and general
16 manager, is it unusual for a plant to be upgraded within
17 five years of initial design and construction?

18 A. I would answer that the answer to that is no, it
19 is not unusual. And again, I would point out that the
20 timing of the upgrades is greatly affected by the growth
21 that the utility is experiencing.

22 The real issue that tends to drive the upgrades
23 is where you are at in terms of capacity relative to the
24 design capacity of the facility. So in the case of a
25 high growth environment where the flows quickly come up

1 to design capacities, then it is not unusual to have
2 operational issues, desires to improve efficiency that
3 would lead you to make upgrades to the facility.

4 Q. In your experience have you seen situations with
5 treatment plants where operational challenges have
6 arisen within a couple or a few years after the plant
7 has been constructed, similar to the type of situation
8 we are talking about here?

9 A. Yes. At Citizens and American Water I was
10 responsible for two different wastewater treatment
11 plants, the one that served originally Sun City West and
12 now serves a much larger area in that vicinity, in the
13 Sun City West. Also I am familiar with the plant that
14 was constructed for the Anthem community. And over the
15 course of the construction and building of those
16 facilities, we incurred situations, operational issues
17 that required upgrades at both of those facilities.

18 One example that comes to mind in Sun City West
19 is we had upgraded the plant to deal with new
20 regulations. And that was to allow for denitrification
21 and tertiary filtering at the plant. It originally was
22 constructed as a secondary treatment plant. We
23 constructed those facilities. And as the flows
24 increased, we found difficulties both with the new
25 clarifier that had been installed as part of that and

1 with the denitrification filters. And we later added
2 methanol feeds to the denitrification filters to improve
3 their efficiency. And then when we expanded the plant
4 the next time, we added additional clarification
5 capacity to assist with the previous clarifier that was
6 not performing as well as we would have liked it to.

7 And Anthem, of course, I think is your, I guess
8 your prototypical rapid growth scenario. I think the
9 whole facility probably went from first shovel in the
10 ground to completion in, I think, about eight years.
11 And that included several phases of construction.

12 Probably the two examples come to mind there,
13 the headworks was originally constructed with six
14 millimeter screens. The operations personnel during
15 operation of the first phase had concluded that six
16 millimeter screens were allowing solids to enter into
17 the facility that was damaging membranes. It was a
18 membrane filtration facility. And so the plant was
19 retrofitted with two millimeter screens. That entails
20 removing the old screens, installing the new screens,
21 reconfiguring the headworks to deal with that additional
22 solids handling equipment to deal with the additional
23 solids that are brought out by the smaller screens.

24 In the other example there, we discovered that
25 the membranes were not as effective at passing peak

1 flows as we had planned for, and so an equalization
2 basin was added so that flows through the filters could
3 be attenuated, again, an operational improvement to that
4 facility.

5 There may be other examples, but those are the
6 ones that, you know, come to mind.

7 MR. WILEY: I have no further questions, Judge.
8 I would tender Mr. Jones for cross-examination.

9 ACALJ NODES: Okay. Well, we will take his
10 cross-examination tomorrow.

11 And Ms. Wood, if you want to present an
12 engineering witness or if any other witness to respond
13 to Mr. Jones after cross-examination, you are certainly
14 entitled to do so. And the company will have the last
15 word, obviously. But you will be given that opportunity
16 as well.

17 MS. WOOD: Your Honor, because I only have
18 tonight to research the testimony this witness just
19 gave, can we at least have him testify the names of the
20 cases in which these improvements were made so that we
21 could do some research about them? He talked about two
22 different cases. I believe one was with Citizens and
23 the other -- Sun City West -- and the other one was with
24 Anthem. And if I could at least have the name or year.

25 ACALJ NODES: The cases?

1 MS. WOOD: That were taken, or in which those
2 issues were taken up, to determine whether or not there
3 are any rulings by the Commission as relative to those.

4 MR. WILEY: Judge, if I could respond, I don't
5 think Mr. Jones said they were cases. I think they were
6 plants. And so I don't know if there is a reference to
7 a specific case, I mean.

8 MS. WOOD: Can we ask the witness?

9 ACALJ NODES: Sure.

10 MR. WILEY: Sure.

11 ACALJ NODES: Yes, go ahead. Go ahead,
12 Mr. Jones, if you are aware of any specific cases.

13 THE WITNESS: Well, the rate base associated
14 with those improvements were likely considered in
15 several cases over the period of those facilities.
16 Anthem has only, I believe, had one rate case or
17 possibly it is two since inception. They are probably
18 on my list here, if I can figure out which ones those
19 would be.

20 I believe the Docket No. SW-01303A-06-0403 would
21 have included the Anthem subsidiaries or service area,
22 and there would have been plant from the treatment plant
23 placed into rate base during that case.

24 MS. WOOD: Is that the 2006 case, Mr. Jones?

25 THE WITNESS: Yes, that would be 2006.

1 MS. WOOD: Okay, thank you.

2 THE WITNESS: And in terms of Sun City West,
3 those would have been more distant in time. I don't
4 know that I could just pick those off the list. I would
5 probably have to look at their entire docket and see the
6 cases and the timing and I could possibly suggest one.
7 I will just add that these upgrades that were done were
8 never at issue in any of those cases. They were
9 recommended by all parties for inclusion in rate base.

10 MS. WOOD: Was it in the time period of 1995 or
11 was it after that?

12 THE WITNESS: Well, certainly all the Anthem
13 cases would have been post 1995.

14 MS. WOOD: I am talking about the Sun City West,
15 Mr. Jones.

16 THE WITNESS: Well, as I look at this, we did a
17 certificate of convenience and necessity expansion in
18 '93. That process actually triggered many of the
19 expansions at the plant that ultimately resulted in the
20 upgrades. And so I would think that at least some of
21 the plant might have been included in the 1995 case, if
22 the wastewater division was part of that case. I don't
23 know that off the top of my head.

24 And then the 2002 Arizona-American Water Company
25 case, again if that would have included the Sun City

1 West operating district, those plant facilities would
2 have been part of that case.

3 MS. WOOD: I have only been around for about a
4 year, so I don't have the history of all these
5 companies. Are you saying in 1995 Sun City West was
6 owned by Citizens and later on they became under this
7 other Arizona-American?

8 THE WITNESS: Yes, that is correct. I believe
9 it was in January of 2002 Arizona-American Water Company
10 bought all of the assets of Citizens Water Resources in
11 Arizona. They didn't buy the companies, they bought the
12 assets. And they immediately, as I recall, filed a rate
13 case in 2002 based on the 2001 test year.

14 The reason I remember that so well is that was a
15 different company's test year, and I can recall that
16 being a major issue in the case.

17 MS. WOOD: Regardless of when the cases were
18 filed, do you know what year the upgrades were made in
19 Sun City West and also the other company, Anthem?

20 THE WITNESS: Not off the top of my head, I
21 couldn't give you the years.

22 MS. WOOD: Okay. And then just, Your Honor, so
23 that I can prepare to cross-examine the witness, can I
24 just ask what he has looked at in order to prepare for
25 his testimony here? I heard him say the testimony of

1 Mr. McBride, Mr. Sorensen, Mr. Rowell, and Mr. Scott.

2 Is that all?

3 THE WITNESS: Yes. I did not -- to clarify, I
4 read the prefilled testimonies of Mr. Sorensen,
5 Mr. McBride, and Mr. Rowell. I listened to Mr. Rowell
6 Monday. I listened to Mr. Scott today, but I did not
7 read Mr. Scott's prefilled testimony.

8 I also reviewed the transcript of Mr. McBride's
9 oral testimony. I reviewed the strategic evaluation
10 that Mr. McBride's engineering company prepared. And I
11 reviewed the design report for the Palm Valley water
12 reclamation facility, the original design report
13 prepared by PACE Advanced Civil Engineering.

14 MS. WOOD: The one we call Phase 1?

15 THE WITNESS: I am not sure of what it has been
16 called in this docket, I guess.

17 MS. WOOD: Is it the first --

18 MR. WILEY: Look at the front page of that. I
19 think it says Phase 1 design report.

20 THE WITNESS: It does say Phase 1 design report,
21 yes. And the last thing I reviewed is a Staff report
22 dated October 18, 2007. Not -- Staff report may be too
23 strong of a word. It is referred to as Staff's field
24 and office visit findings, and it was in the matter of
25 the inquiry into the operational practices of Litchfield

1 Park Service Company. The docket number there was
2 SW-01428A-07-0602.

3 MS. WOOD: And then last question, when were you
4 retained in this matter?

5 THE WITNESS: Mr. Wiley called me at home on
6 Sunday evening.

7 MS. WOOD: Thank you.

8 THE WITNESS: Last Sunday.

9 ACALJ NODES: Do you have any additional
10 questions at this point?

11 MS. WOOD: No, Your Honor. Thank you, though.

12 ACALJ NODES: Okay. All right. Well, I think
13 we will -- now, tomorrow we are going to do cross on
14 Mr. Jones. And then you are going to put Mr. Sorensen
15 on? Okay.

16 THE WITNESS: Done with me, Your Honor?

17 ACALJ NODES: Yes. You are excused for tonight.

18 And then RUCO will be given an opportunity to
19 respond to Mr. Jones if they want to put a witness on,
20 and you will have the final say if you need to do that.

21 And one final thing, Ms. Wood, with respect to
22 your statement about you only did direct on rejoinder,
23 you may want to check your direct on Mr. Rowell in which
24 you were allowed 12 pages to respond not to rejoinder
25 but to oral testimony, and in which I admitted an

1 exhibit over Mr. Wiley's strenuous objection. So if
2 that gives you any comfort, you may want to take a look
3 at that.

4 Okay. Let's break until 9:30 tomorrow morning.

5 MR. SHAPIRO: Are we in here, Judge?

6 ACALJ NODES: Yes.

7 MR. SHAPIRO: So we can leave stuff in here?

8 ACALJ NODES: Yes.

9 MS. WOOD: And, Your Honor, can we just start a
10 little bit later tomorrow?

11 ACALJ NODES: Well, we can. I think I told
12 everybody Friday I need to have a window from about
13 11:30 to 1:30. So we are, if we start later tomorrow,
14 we are going to have less time in the morning. But we
15 can start at 10:00. That's about as far as we can go.
16 Otherwise, we --

17 MS. WOOD: And just for ease so that Mr. Jones
18 doesn't have to travel unnecessarily, could we do
19 Mr. Sorensen in the morning, for which we are prepared?
20 And then we can have that additional time during the
21 lunch break to continue with our part for Mr. Jones.

22 MR. SHAPIRO: I don't know that Mr. Sorensen
23 will take that long.

24 MR. WILEY: Actually, I have my own scheduling
25 issues tomorrow, Judge. I am scheduled to leave on a

1 family vacation at 3:00.

2 MS. WOOD: That didn't matter much when I wanted
3 a break, so...

4 MR. WILEY: I prefer to start Mr. Jones at
5 10:00.

6 ACALJ NODES: Let's start Mr. Jones at 10:00 and
7 we will see where we get. And, you know, if you need
8 more time, you can make your argument about that. And,
9 you know, I will take it under consideration.

10 MS. WOOD: Thank you, Your Honor.

11 ACALJ NODES: All right. We will break until
12 10:00 tomorrow morning.

13 (The hearing recessed at 4:34 p.m.)

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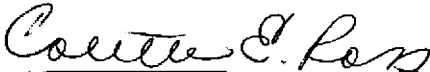
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1 STATE OF ARIZONA)
2) ss.
3 COUNTY OF MARICOPA)
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